UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624
	§	**(Consolidated)**
	§	
	§	CLASS ACTION
This Document Relates To:	§	
MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
ENRON CORP., et al.,	§	
Defendants.	§	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
KENNETH L. LAY, et al.,	§	
Defendants.	§	

LEAD PLAINTIFF'S SUPPLEMENT TO OPPOSITION TO MOTIONS TO DISMISS FILED BY JP MORGAN, CITIGROUP AND MERRILL LYNCH

1685

For purposes of the Court's consideration of defendants' motions to dismiss and Lead Plaintiff's opposition, Lead Plaintiff provides the Court with the following:

1. Complaint in *SEC v. J.P. Morgan Chase & Co.,* No. 03-2877 (S.D. Tex. July 28, 2003), attached hereto as Ex. A;

2. *In the Matter of Citigroup, Inc.*, Admin. Proceeding No. 3-11192, Order Instituting a Public Administrative Proceeding Pursuant to §21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease and Desist Order and Other Relief, dated July 28, 2003, attached hereto as Ex. B;

3. Letter dated September 17, 2003 from the U.S. Department of Justice, Enron Task Force to Merrill Lynch & Co. Inc., attached hereto as Ex. C; and

4. Indictment in *United States v. Daniel Bayly, James A. Brown and Robert S. Furst*, No. 03-CR-363 (S.D. Tex. Sept. 16, 2003), attached hereto as Ex. D.

DATED: September 23, 2003

Respectfully submitted,

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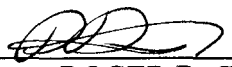

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing LEAD PLAINTIFF'S SUPPLEMENT TO OPPOSITION TO MOTIONS TO DISMISS FILED BY JP MORGAN, CITIGROUP AND MERRILL LYNCH document has been served by sending a copy via electronic mail to serve@ESL3624.com on this 23rd day of September.

I further certify that a copy of the foregoing LEAD PLAINTIFF'S SUPPLEMENT TO OPPOSITION TO MOTIONS TO DISMISS FILED BY JP MORGAN, CITIGROUP AND MERRILL LYNCH document has been served via overnight mail on the following parties, who do not accept service by electronic mail on this 23rd day of September.

Carolyn S. Schwartz
United States Trustee, Region 2
33 Whitehall Street, 21st Floor
New York, NY 10004

Mo Maloney

EXHIBIT A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,	§	
Plaintiff,	§	Civil Action No.
v.	§	**COMPLAINT**
J.P. MORGAN CHASE & CO.,	§	JURY DEMANDED
Defendant.	§	

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

SUMMARY

1. J.P. Morgan Chase & Co. ("Chase") aided and abetted Enron Corp.'s ("Enron") manipulation of its reported financial results through a series of complex structured-finance transactions, called "prepays," over a period of several years preceding Enron's bankruptcy. These transactions were used by Enron to report loans from Chase as cash from operating activities. Indeed, the structural complexity of these transactions had no business purpose aside from masking the fact that, in substance, they were loans from Chase to Enron.

2. Chase knew, because it helped Enron structure these transactions, that prepays were loans structured as a series of commodity trades for accounting and financial reporting purposes. As Chase knew, Enron engaged in prepays to match its so-called mark-to-market earnings (paper earnings based on changes in the market value of certain assets held by Enron) with cash flow from operating activities. By matching mark-to-market earnings with cash flow from operating activities, Enron sought to convince analysts and credit rating agencies that its reported mark-to-market earnings were real, i.e., that the value of the underlying assets would ultimately be converted into cash.

3. As Chase also knew, prepays yielded another substantial benefit to Enron: they allowed Enron to hide the true extent of its borrowings from investors and rating agencies because sums borrowed in prepay transactions appeared as "price risk management liabilities" rather than "debt" on Enron's balance sheet. In addition, Enron's obligation to repay those sums was not otherwise disclosed. Significantly, Chase considered prepays to be unsecured loans to Enron, rather than commodity trading contracts, and based its decisions to

participate in these transactions primarily on its assessment of Enron's credit.

4. Between December 1997 and September 2001, Chase effectively loaned Enron a total of approximately $2.6 billion in the form of seven prepay transactions. Chase was willing to engage in the transactions because they generated substantial fees and as an accommodation to an important client.

5. Based on this conduct, Chase aided and abetted Enron's violations of the antifraud provisions of the federal securities laws. The Commission requests that this Court permanently enjoin Chase from violating Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5, order Chase to disgorge ill-gotten gains, order Chase to pay civil penalties, and order such other and further relief as the Court may deem appropriate.

JURISDICTION AND VENUE

6. The Court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. § 78u(d) and (e), and 78aa].

7. Venue lies in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa] because certain acts or transactions constituting the violations occurred in this District.

8. In connection with the acts, practices, and courses of business alleged herein, Chase, directly or indirectly, made use of the means and instruments of transportation and communication in interstate commerce, and of the mails and of the facilities of a national securities exchange.

9. Chase, unless restrained and enjoined by this Court, will continue to engage in transactions, acts, practices, and courses of business as set forth in this Complaint or in similar illegal acts and practices.

DEFENDANT

10. J.P. Morgan Chase & Co., a Delaware corporation headquartered in New York, New York, is a financial holding company created by the December 31, 2000, merger of J.P. Morgan & Co. Incorporated with The Chase Manhattan Corporation. As of December 31, 2002, Chase had $759 billion in assets and $42 billion in stockholders' equity. At all relevant times, Chase's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and was listed for trading on the New York Stock Exchange (symbol "JPM").

ENRON CORP.

11. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange (symbol "ENE"). Between 1997 and 2001, Enron raised billions in the public debt and equity markets. Until its bankruptcy filing in December 2001, Enron was number

seven on the Fortune 500 list of largest corporations in the United States based on reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. The Company also created and traded financial products. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped in less than a year from more than $80 per share to less than $1.

FACTUAL ALLEGATIONS

PREPAYS WERE STRUCTURED TO DISGUISE THE FACT THAT THEY WERE LOANS.

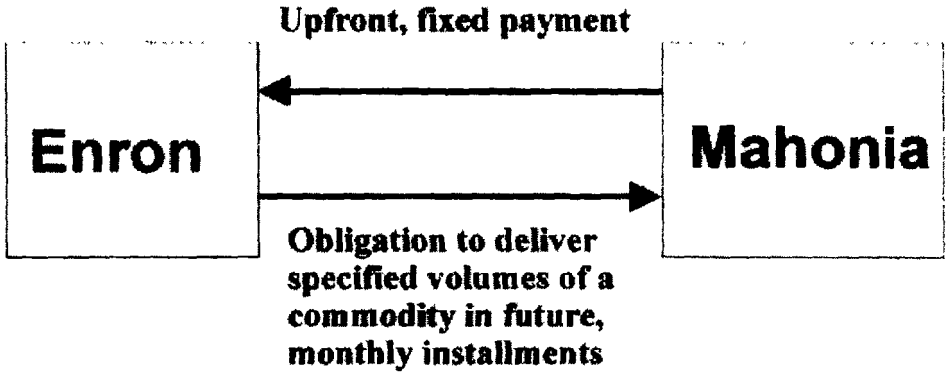
12. The clearest indication that Chase/Enron prepays were disguised loans was their structure. In general, in a prepay transaction (also known as a prepaid forward sale contract) the purchaser pays for a commodity upfront, in full, at the time the contract is made, and the seller agrees to deliver the subject commodity on future dates, often over the course of several years. In effect, the seller bets that the market price of the subject commodity would be lower at the time of delivery than at the time the contract is made. The purchaser bets the opposite way: that the market price of the commodity at the time of delivery will exceed the price it paid at the time of contracting. In a typical prepay transaction, therefore, each side assumes commodity price risk.

13. The critical difference in the Chase/Enron prepays -- and the reason that these transactions were in substance loans -- was that they employed a structure that passed the counter-party commodity price risk back to Enron, thus eliminating all commodity risk from the transaction. As in typical prepays, Enron received cash upfront. In contrast to typical prepays, however, with all elements of the structure taken together, if all parties performed as expected, Enron's future obligations were distilled to repayment of that cash with negotiated interest. The interest amount was set at the time of the contract and was independent of any changes in the price of the underlying commodity. This was accomplished through a series of simultaneous trades whereby Enron passed the counter-party commodity price risk to a Chase-sponsored special purpose vehicle ("SPV"), which passed the risk to Chase, which, in turn, passed the risk back to Enron.

14. Generally, the SPV was one of two Isle of Jersey companies, collectively known as Mahonia. (Unless a specific entity is named, the name "Mahonia" is used here to refer to two entities named Mahonia Limited and Mahonia Natural Gas Limited. All but one of the transactions described here used Mahonia Limited as the third participant, the remaining transaction used Mahonia Natural Gas Limited. These SPVs were essentially identical in format and operation and were functionally interchangeable.) Mahonia was controlled by Chase and was directed by Chase to participate in the transactions ostensibly as a separate, independent, commodities-trading entity. In fact, however, the SPV had no independent reason to participate in these transactions; as Chase knew, Mahonia was included in the structure solely to effectuate Enron's accounting and financial reporting goals.

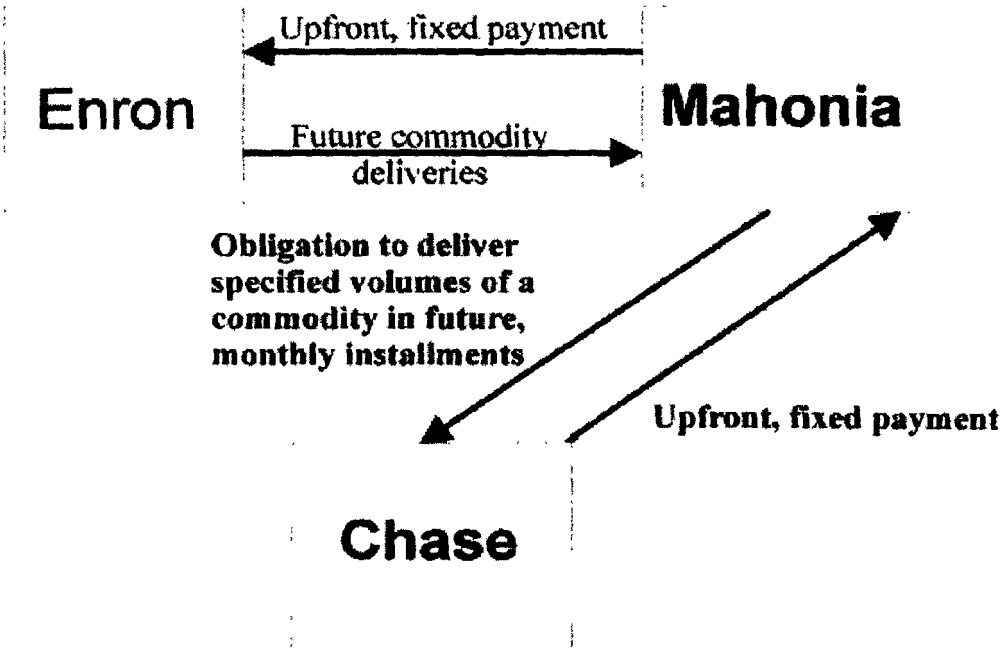
15. Generally, Chase/Enron prepay transactions consisted of four sets of simultaneously executed contracts. These transactions allowed for large payments by Chase to Enron and an obligation by Enron to pay the money back with interest -- a classic loan. To wit:

16. ENRON - MAHONIA PREPAID FORWARD SALE CONTRACT



- Pursuant to this contract, Enron received a large, upfront payment from Mahonia and was obligated to make future, monthly deliveries to Mahonia of specified volumes of a commodity at specified locations. (Enron's obligation to begin delivering the commodity usually began three months after the contract's execution and lasted for three to five years from the execution date.) Viewed in isolation, this contract exposed Mahonia to commodity price risk

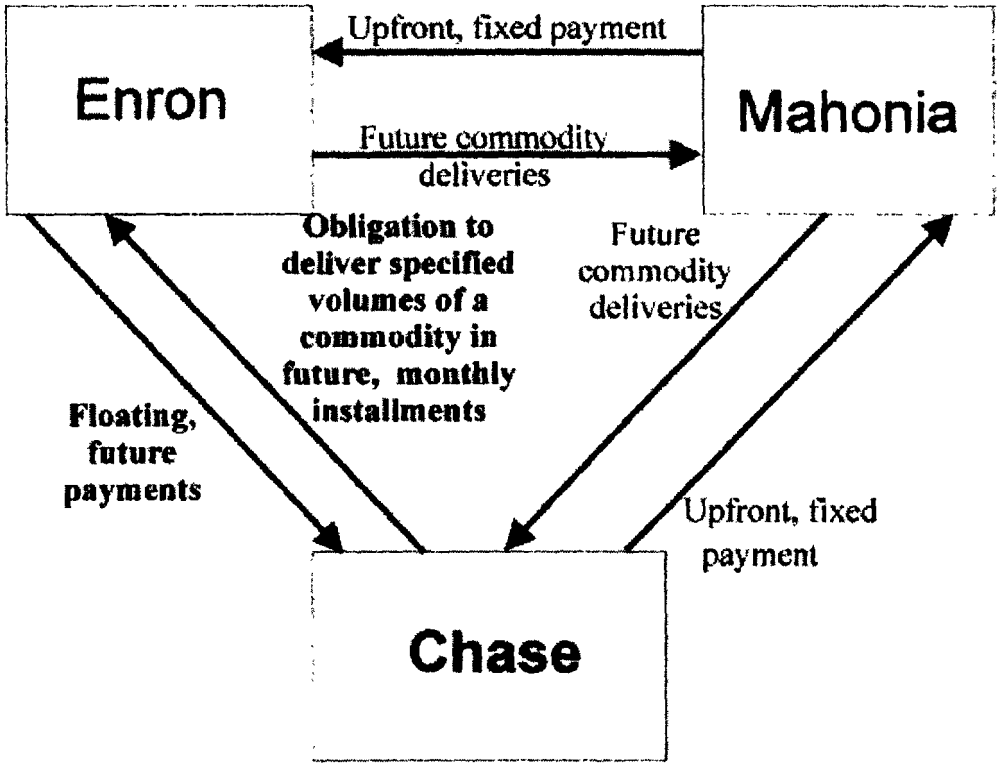
17. MAHONIA - CHASE PREPAID FORWARD SALE CONTRACT



- Pursuant to this contract, Mahonia received an upfront payment from Chase and was obligated to make future, monthly deliveries to Chase of specified volumes of a commodity at specified locations. The amount that Chase paid Mahonia pursuant to this contract was essentially the same as Mahonia's payment to Enron. (Chase's payment to Mahonia usually exceeded Mahonia's payment to Enron by the amount of Mahonia's fee for participating in the transaction; typically $5,000 to $12,000.) In essence, Chase funded Mahonia's upfront payment to Enron.

- In all material respects, the prepaid forward contract between Mahonia and Chase contained the same terms as the Enron/Mahonia prepaid forward contract, i.e., the same delivery dates, delivery points, and volumes. Thus, Mahonia's commodity price risk was passed through to Chase.

18. SALE OF COMMODITY BY CHASE TO ENRON

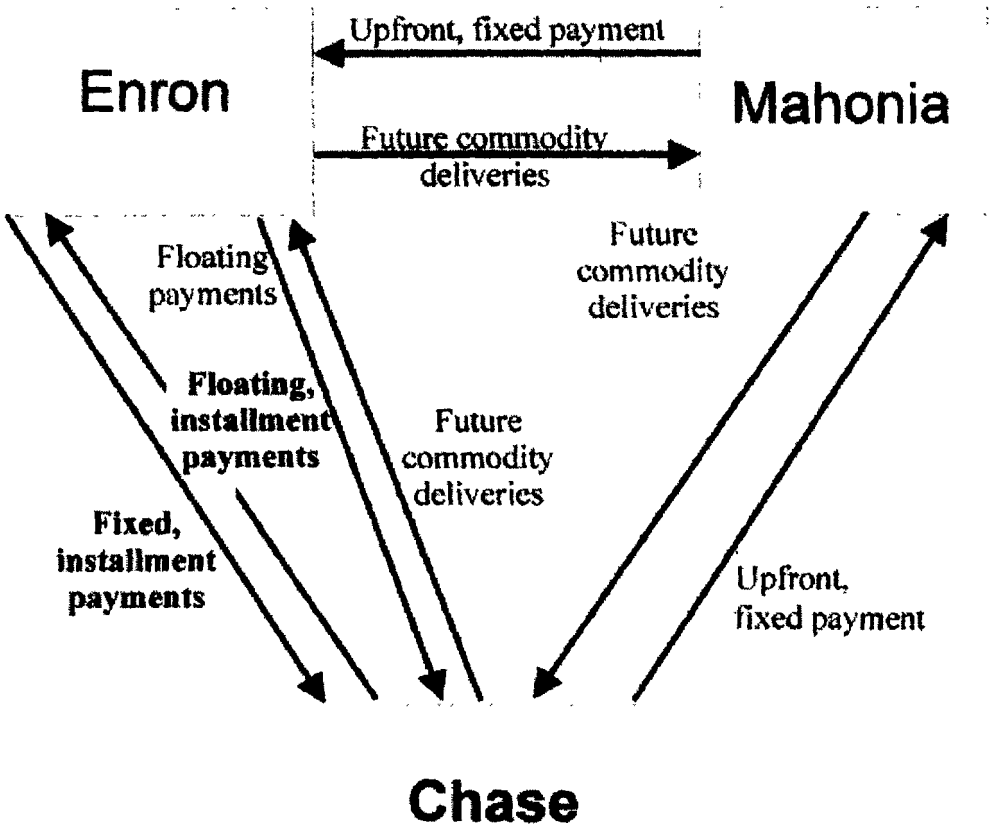


- Pursuant to this contract, Chase obligated itself to deliver the same commodity back to Enron on the same delivery dates at the same delivery points specified in the Enron/Mahonia and Mahonia/Chase forward contracts.

- In exchange, Enron agreed to make periodic payments to Chase that varied (floated) with the changes in the price of the subject commodity because they were calculated with reference to a specified commodity index at the time of delivery. Since payments to Chase were based on

an index of a commodity, Chase continued to be subjected to commodity price risk.

19. CHASE - ENRON SWAP



- Chase passed its commodity price risk back to Enron by entering into a variable for fixed swap agreement. The swap agreement obligated Chase to make future, variable (or floating) payments to Enron. The floating payments under the swap agreement were always equal to the payments that Enron made to Chase in connection with its sale of the commodity back to Enron. In effect, the two payments cancelled each other out. In exchange, Enron was obligated to make fixed installment payments to Chase. The fixed payments were calculated to provide Chase with the return of its principal (i.e., the upfront payment to Mahonia which was passed to Enron) plus an agreed upon interest amount.

20. The volumes specified in the agreements had nothing to do with commodity trading. Instead they were based on the amounts Enron wanted to borrow. To arrive at the volume of the referenced commodity to be specified in a prepay contract, Enron and Chase divided the sum of the borrowed amount and interest by a negotiated per-unit price of the referenced commodity. As a

Chase e-mail explained, "[a]s before, assume we will tweak either the volume or the price to hit the [desired] $350MM [loan amount]."

21. Four of the seven prepay transactions that are the subject of this complaint used the structure set out above. The other three used structures that were variants of the same concept; all structures achieved the same result by passing the counter-party commodity price risk back to Enron.

22. One of the other structures, the first prepay transaction executed by the parties during the relevant time period, was the same as the structure set out above except that it contemplated that Chase would sell the commodity in the open market. (Despite the contemplation of a sale in the open market, Chase still passed its commodity price risk to Enron by operation of a swap whereby, in effect, Chase passed the open market price to Enron in exchange for fixed payments.) However, Enron's appetite for additional cash from operating activities created a risk that Chase would not be able to sell efficiently the commodities it received in prepay transactions. In part for that reason, in subsequent prepay transactions, the parties agreed to have Chase deliver the commodities back to Enron, thus effectively eliminating the need for any actual commodity transport to take place. (In commodities trading, delivery is deemed to take place when title to the specified amount of a commodity passes.) For example, in a taped conversation, Enron and Chase employees discussed the fact that it did not matter if the volumes to be delivered actually exceeded the total capacity of the pipeline at a specified delivery point "because [Enron was] going to get [the commodity] back from [Chase]" at the same time. However, they agreed that it would be best to avoid such a circumstance because it might "raise a red flag." (This and all other recordings of conversations referenced in this complaint were made in the normal course of recording trading desk telephone conversations.)

23. Another prepay transaction employed a structure that used two SPVs, Mahonia Natural Gas Limited and Stoneville Aegean Limited ("Stoneville"). Like Mahonia, Stoneville was created by a Jersey law firm, Mourant du Feu & Jeune ("Mourant"), and controlled by Chase. In this structure, as in the structure detailed above, Chase sent the upfront payment to Enron via Mahonia and was to receive future delivery of the commodity also via Mahonia. To eliminate its price risk, Chase entered into a forward sale of the same volume of the commodity, on the same delivery dates, at the same delivery points to Stoneville. Stoneville, in turn, sold back to Enron the same volume of the commodity, on the same delivery dates, at the same delivery points. The payment from Enron to Chase via Stoneville was greater than the amount sent from Chase to Enron via Mahonia. The difference in those amounts was the equivalent of interest on a loan.

24. In a final iteration of the prepay structure, employed in the last Chase/Enron prepay transaction, physically-settled forward sales contracts were replaced with financially-settled swap agreements between Enron and Mahonia, Mahonia and Chase, and Chase and Enron. Here, Chase again made an upfront payment to Enron via Mahonia. But, instead of Enron agreeing to make a future delivery of a commodity to Chase (via Mahonia), Enron agreed to make future cash payments to Chase (via Mahonia) in amounts representing the value of a given volume of a designated commodity at a given time. As in the structure detailed in the schematics above, Chase

returned its price risk back to Enron by operation of a swap with Enron. This swap replaced Chase's stream of floating payments from Enron (via Mahonia) with a stream of fixed payments directly from Enron representing repayment of principal and interest.

25. In sum, in these seven prepay transactions with Chase, Enron received large, upfront payments from Chase via Mahonia; Enron was obligated to make periodic payments to Chase to repay principal and interest; the interest was calculated with reference to LIBOR, and all price risk and, in certain transactions, even the obligation to transport a commodity were eliminated. The only risk in the transactions was Chase's risk that Enron would not make its payments when due, i.e., credit risk. In short, these prepays were in substance loans.

26. Internally, Chase viewed Enron prepays as disguised loans. For example, a Chase employee wrote in an August 17, 1999 memorandum, "[j]ust to fill you in, a few things have occurred since we booked the recent Prepaid Forward deals, . . . [l]oans disguised as derivatives are now known as 'Derivatives Based Funding' ('DBFs') . . . Prepaid Forward Trades [are on] the list of DFBs [sic]." A Chase approval document describing the "Principal Characteristics" of a prepay transaction stated, "[a]mortization begins April 6, 2002 . . . with interest capitalized until that payment." In audiotaped discussions regarding this transaction, Chase officials sometimes referred to the transaction as a "loan." Even Chase's own auditors described one of the prepay transactions as follows: "The combined effect of the entire structure is similar to a lending transaction where Chase grants Enron (indirectly through Mahonia) a $500 million loan on June 29, 1999 and the repayments of principal and interests [sic] will take place in a 5-year period that begins in October 1999."

27. In an internal Chase e-mail, one of Chase's most senior officers referred to certain structured transactions, including prepays similar to the prepays with Enron, as disguised loans. He said:

    WE ARE MAKING DISGUISED LOANS, USUALLY BURIED IN COMMODITIES OR EQUITIES DERIVATIVES (AND I'M SURE IN OTHER AREAS). WITH AFEW [sic] EXCEPTIONS, THEY ARE UNDERSTOOD TO BE DISGUISED LOANS AND APPROVED AS SUCH.
    (Capitalization in the original.)

28. Notably, however, this executive was not concerned that he was addressing transactions that were different substantively from what they appeared to be. His concern was only that disguised loans be treated as loans internally at Chase, for approval and tracking purposes:

    I THINK WE NEED A POLICY TASK FORCE TO NOT ELIMINATE DISGUISED LOANS BUT TO MAKE SURE THEY ARE DONE RIGHT, THAT THEY ARE TRANSPARENT [internally at Chase] AND DON'T DISAPPEAR FROM OUR RADAR SCREEN.
    (Capitalization in the original, emphasis added.)

29. Through these seven prepay transactions between December 1997 and September 2001, unbeknownst to investors, analysts, and rating agencies, Chase effectively loaned Enron a total of approximately $2.6 billion.

CHASE KNEW THAT ENRON WAS USING PREPAYS TO INFLATE ITS FINANCIAL RESULTS.

30. Enron used fair value accounting (sometimes referred to as mark-to-market accounting) for certain contracts and financial instruments related to its trading activities; for hedging related to non-trading activities; and for investments in businesses seeking debt or equity financing. Using fair value accounting, Enron recorded certain types of assets and liabilities at their current fair value rather than their historical cost, such that any changes in the fair value of those assets and liabilities were reflected as gains or losses for the reporting period in which the changes occurred. Increases in the fair value of assets accounted for by Enron on a fair value basis generated current period earnings without generating any associated cash flow from operating activities.

31. As Chase knew, Enron engaged in prepays to match its reported fair value earnings with reported cash flow from operating activities to convince analysts and credit rating agencies that Enron's fair value earnings were real, i.e., that the reported fair value earnings represented gains that could and, eventually would, be turned into cash.

32. As Chase knew, because prepays were disguised loans, Enron not only overstated its cash flow from operating activities, but it understated its cash flow from financing activities and understated debt on its balance sheet. Chase knew that, as a result, analysts and credit rating agencies were being misled.

33. For example, in a November 25, 1998 e-mail, a Chase employee explained to a colleague, "Enron loves [prepays] as they are able to hide funded debt from their equity analysts because they (at the very least) book it as deferred [revenue] or (better yet) bury it in their trading liabilities." (Emphasis in the original.)

34. In December 1998, Chase met with Enron's Treasurer and other Enron officials to discuss possible ways of refinancing prepays along with certain other transactions in a manner that would shift Chase's credit exposure to other parties. A Chase memorandum summarizing the meeting explained that "[a]lthough there are a myriad of issues [regarding a potential repackaging of some of this exposure], an initial list would include: ... Rating agency knowledge of existing deals. Some deals that are less know [sic] to the agancies [sic] may come to light if they are placed in newly formed rated vehicles. This could well cause some heartburn for Enron."

35. Similarly, in a November 13, 2000 memorandum regarding Enron's desire to execute a $500 million year-end prepay to "fill [Enron's] liquidity gap" [i.e., mismatch between earnings and cash flow from operating activities] and Chase's desire to fill that gap without taking on additional exposure to Enron credit risk, a Chase employee wrote, "[w]e concluded that there were probably three funding alternatives beyond our usual execution [including a commercial paper] conduit - the challenge here is disclosure in the public domain." (Emphasis added.)

36. During a September 13, 2001 audio-taped phone call between Chase employees, one Chase employee described another contemplated prepay transaction as "discreetly get[ting Enron] you know several hundred million dollars and hav[ing] no market knowledge of what's going on."

37. Significantly, Chase knew exactly how Enron treated prepay proceeds on its financial statements. For example, a May 1999 Chase letter to Enron written in advance of a meeting to review Enron's debt and cash flows attached excerpts of Enron's 1998 financial statements. Chase made notations on the excerpted statements to reflect its understanding of the way prepays and certain other transactions would (or would not) be reflected in Enron's financial reporting. The word "Prepays" had been typed on the balance sheet and on the statement of cash flows with arrows pointing to the balance sheet line for "Liabilities from price risk management activities" and to the statement of cash flows line for "Net assets from price risk management activities." In other words, Chase knew that prepays did not appear as funded debt and that they increased reported net cash flow from transactions involving mark-to-market assets.

CHASE KNOWINGLY ASSISTED ENRON IN DISGUISING THE TRUE CHARACTERISTICS OF THE TRANSACTIONS FOR ENRON'S ACCOUNTING PURPOSES.

38. Enron's auditor, Arthur Andersen LLP ("Andersen") developed certain criteria that it used to justify Enron's accounting treatment of the prepay transactions. These criteria included:

    - The existence of an independent, third-party entity in the transaction structure -- this entity was supposed to be a "substantive" business with operations independent of the other parties and could not be an SPV sponsored by one of the other parties;

    - a true commercial purpose for the transactions and documentation that was "standard" for commodity trades; and

    - actual risk for the parties related to fluctuations in the price of the commodity.

39. Mahonia was not an independent, third-party entity with substantive business operations. Although Mahonia was legally separate from Chase, it was created at the direction of Chase and was completely controlled by Chase. Enron told Chase it needed Mahonia in the transactions for its own accounting reasons. Chase used Mahonia to help Enron achieve its accounting objectives.

40. When the first Mahonia entity, Mahonia Limited, was formed in 1992, the Mourant law firm described it in formation documents as a "finance company." Subsequently, in formation documents for Mahonia Natural Gas Limited, filed in 2000, Mourant represented that Mahonia's purpose was "to assist in transactions arranged by Chase Bank" and explained further:

    [Mahonia] will be invited from time to time to enter into arrangements that will assist the Chase Manhattan Bank in providing finance for major US Oil and Gas companies. The arrangements in each case will involve [Mahonia]

entering into a Forward Purchase Contract with a US Oil or Gas company . . . [Mahonia] will also at the same time enter into a Forward Sale Contract with Chase . . . *The overall effect of these arrangements will be that Chase will be providing finance to the relevant US Oil or Gas company on the security of the inventory of Oil or Gas but without [Mahonia] taking any exposure to the Oil and Gas market.*
(Emphasis added.) (The words Natural Gas Limited were specifically added to the name of the new Mahonia entity to make it sound like a substantive commodities trading company.)

41. Mahonia had no business operations other than to facilitate Chase's accounting-driven transactions with its clients. In fact, it had no employees and no offices. Mourant employees performed limited administrative functions on its behalf. Chase employees performed all substantive functions (i.e., negotiating with Enron, drafting contracts, and handling payments). For example, a Company Formation Questionnaire that was prepared by Mourant in December 2000 for filing with the Jersey regulatory authority was sent to a Chase in-house lawyer for his "approval and signature" and listed two Chase employees as the contact persons for Mahonia.

42. Mahonia was completely controlled by Chase. Mahonia never entered into a commercial transaction in which Chase was not involved. (Conversely, Mahonia never refused a request by Chase to enter into a prepay transaction.) In each of the prepay transactions described here, Mahonia and Chase executed Security Agreements as part of the prepay transactions that gave Chase an interest in "any assets Mahonia then owned or thereafter acquired" and contained covenants that Mahonia "would 'exercise its rights, authorities and discretions under or in respect of' . . . all current and subsequently obtained assets 'in such manner as [Chase] may from time to time require.'" Effectively, it would have been necessary for Mahonia to obtain Chase's consent before entering into any transaction not involving Chase.

43. Chase prepared and reviewed transaction documents on behalf of Mahonia and forwarded the documents to Mourant attorneys for Mahonia to sign. Chase also edited Mourant's legal opinions and drafts of Mahonia's Board minutes. In one instance, Chase wrote Mourant, "You will only be required to have the forms signed for Mahonia. . . . For the time being, you should hold [the documentation] until further instructed."

44. Chase paid all administrative and regulatory fees incurred by Mahonia and also paid Mourant's legal fees. All of Mahonia's bank accounts used to funnel the payments between the parties were held at Chase; Chase had full control over all Mahonia cash inflows and outflows relating to the prepay transactions.

45. Despite its relationship with Mahonia, Chase helped Enron maintain an illusion that Mahonia was an independent, third party engaged in the commodities business. While Chase and Enron were working on the September 2001 prepay transaction, Andersen requested a letter from Mahonia containing certain representations regarding its status. Chase and Enron worked together to craft a letter that would satisfy Andersen without revealing the relationship between Chase and Mahonia. In an audio-taped conversation on September 13, 2001, among Chase and Enron employees, Enron employees

told Chase of the need to make Mahonia seem independent for Enron's accounting purposes:

> [1st Enron employee]: You're talking about the rep letter from Mahonia .... Basically, ... before what we've done is just looked at the actual [Mahonia] charter and use that as information [to establish that Mahonia was independent] but now Andersen is pushing back and saying hey we need to have a specific rep letter, that [a] representative of Mahonia signed, that reps certain point.
>
> [2nd Enron employee]: Which is [that Mahonia is] separate from Chase, doesn't have Chase showing up anywhere on the fax letterhead or anything along those lines except for fax number, etc.
>
> ...
>
> [3rd Enron employee]: ... From [Chase's] side, you also want to make sure that Mahonia *seems independent*.
> (Emphasis added.)

46. Further promoting the illusion that Mahonia was a real entity for Enron's accounting purposes, each of the forward sale contracts between Enron and Mahonia contained a representation by Mahonia that it "entered into this transaction for commercial purposes related to its business as a producer, processor, or merchandiser of Natural Gas or natural gas liquids" and that it had "the capacity, and intends, to take delivery of the Natural Gas to be delivered hereunder."

47. Chase reviewed and specifically considered and approved this representation in-house. This representation was false and misleading. As previously discussed, the first Mahonia entity was described as a "finance company" in its formation documents, whereas the formation documents for Mahonia Natural Gas Limited stated, "[t]he overall effect of these arrangements will be that Chase will be providing finance to the relevant US Oil or Gas company on the security of the inventory of Oil or Gas but without [Mahonia] taking any exposure to the Oil and Gas market." In any event, as Chase knew, Mahonia participated in transactions with Enron for one reason only: it was used by Chase to accomplish Enron's accounting objectives.

48. The false and misleading nature of the representations that Mahonia was an independent merchandiser of natural gas became further evident when Enron was on the brink of defaulting on its prepay obligations just before it filed for bankruptcy protection. Initially, Chase had not included cross-default provisions in its prepay contracts with Mahonia. Accordingly, even if Enron defaulted on its obligation to deliver a commodity to Mahonia, ostensibly Mahonia would be obligated still to deliver commodity to Chase.

49. Under the terms of the various prepays, in case of an Enron default, Mahonia was entitled to receive a fixed sum consisting of certain insurance proceeds and cash collateral. Mahonia's obligation to make future commodity deliveries to Chase would therefore expose Mahonia to commodity price risk, i.e., the risk that the fixed sum it received as a result of Enron's default would be insufficient to fulfill its future obligations to Chase. Mahonia could not be

exposed to this risk (because of the representations it made to the Jersey authorities that it was in the business of providing finance) and it could not hedge it.

50. Acknowledging the reality that prepays were transactions solely between Chase and Enron, immediately prior to Enron's bankruptcy, Chase took unilateral action to amend the original agreements with Mahonia to add cross-default provisions in order to be able to terminate the prepays if Enron defaulted.

CHASE AIDED AND ABETTED ENRON'S FRAUD.

51. Enron prepared its statements of cash flows using a method that reconciled net income to the amount of net cash generated by (or used in) operations that indicated whether, on a net basis, Enron's cash inflows and outflows from operations were positive or negative; i.e., generating or using up cash. Enron's prepay transactions had the effect of overstating this balance - either by causing net cash generated by operating activities (a positive cash flow) to be higher or by causing net cash used in operating activities (a negative cash flow) to be less than what should have been reported.

52. For the year ended December 31, 1997, a prepay transaction totaling approximately $300 million increased reported net cash purportedly generated by operating activities from $201 million to $501 million. For the second quarter of 1998, a prepay transaction totaling approximately $250 million reduced reported net cash purportedly used in operating activities from ($381) million to ($131) million. For the year ended December 31, 1998, a prepay transaction totaling approximately $250 million increased reported net cash purportedly generated by operating activities from $1.39 billion to $1.64 billion. For the second quarter of 1999, a prepay transaction totaling approximately $500 million reduced reported net cash purportedly used in operating activities from ($538) million to ($38) million. For the second quarter of 2000, a prepay transaction totaling approximately $650 million reduced net cash purportedly used in operating activities from ($1.197) billion to ($547) million. For the year ended December 31, 2000, a prepay transaction totaling approximately $330 million increased reported net cash purportedly generated by operating activities from $4.45 billion to $4.78 billion. For the third quarter of 2001, a prepay transaction totaling approximately $350 million reduced reported net cash purportedly used in operating activities from ($1.103) billion to ($753) million.

53. As a result of the conduct described in Paragraphs 1 through 52, Enron materially overstated its reported net cash flow from operating activities, materially understated its reported net cash flow from financing activities, and misrepresented the amount it borrowed. As more fully alleged in Paragraphs 1 through 52, Chase knowingly provided substantial assistance to Enron in this conduct, thereby aiding and abetting Enron's fraud.

CLAIMS FOR RELIEF

FIRST CLAIM

Aiding and Abetting Violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5]

54. Paragraphs 1 through 53 are re-alleged and incorporated by reference herein.

55. As set forth more fully above, Enron, directly or indirectly, by use of the means or instrumentalities of interstate commerce, or by the use of the mails and of the facilities of a national securities exchange, in connection with the purchase or sale of securities: has employed devices, schemes, or artifices to defraud, has made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or has engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

56. As detailed above, Chase knowingly provided substantial assistance to Enron in violation of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5].

57. Based on the foregoing, Chase aided and abetted violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5].

JURY DEMAND

58. The Commission demands a jury in this matter.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

A. Grant a Permanent Injunction restraining and enjoining Chase from violating the statutory provisions set forth herein; ordering Chase to pay disgorgement of illegal gains, and ordering Chase to pay civil penalties;

B. Pursuant to Section 308 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002), enter an order providing that the amount of civil penalties ordered against Chase be added to and become part of a disgorgement fund for the benefit of the victims of the violations alleged herein; and

C. Grant such other and additional relief as this Court may deem just and proper.

Dated: July ___, 2003

Respectfully submitted,

_____

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Deputy Director, Division of Enforcement
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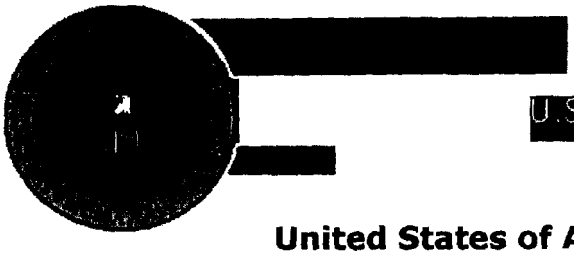
http://www.sec.gov/litigation/complaints/comp18252.htm

EXHIBIT B



U.S. Securities and Exchange Commission

United States of America
before the
Securities and Exchange Commission

Securities Exchange Act Of 1934
Release No. 48230 / July 28, 2003

Accounting And Auditing Enforcement
Release No. 1821 / July 28, 2003

Administrative Proceeding
File No. 3-11192

In the Matter of Citigroup, Inc. Respondent.	:	ORDER INSTITUTING A PUBLIC ADMINISTRATIVE PROCEEDING PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND OTHER RELIEF

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to institute a public administrative proceeding pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Citigroup, Inc. ("Citigroup") and such a proceeding is hereby instituted.

II.

In anticipation of the institution of this proceeding, Citigroup has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R.Sec. 201.100 *et seq.*, Citigroup, without admitting or denying the findings contained herein, except that Citigroup admits to the jurisdiction of the Commission over it and over the subject matter of this proceeding, consents to the issuance of this Order Instituting a Public Administrative Proceeding Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Other Relief ("Order").

III.

The Commission makes the following findings:[1]

A. Introduction

Citigroup assisted two Houston-based energy companies, Enron Corp. ("Enron") and Dynegy Inc. ("Dynegy"), in enhancing artificially their financial presentations through a series of complex structured transactions whose purpose and effect, among other things, was to allow those companies to report proceeds of financings as cash from operating activities on their statements of cash flows. In these transactions, Enron and Dynegy received cash upfront and repaid that cash on terms that included a negotiated return in the nature of interest.[2] Nonetheless, Enron and Dynegy did not disclose that these transactions were financings or report them as such. Instead, these transactions were structured purportedly to take advantage of certain accounting rules so that Enron and Dynegy could report them on their balance sheets as "price risk management liabilities," "minority interest," or otherwise.

1. Enron Corp.

Enron used fair value accounting for certain contracts and financial instruments related to its trading activities; for hedging related to non-trading activities; and for merchant investments, described by Enron as providing capital primarily to energy and communications-related businesses seeking debt or equity financing.[3] Increases in the fair value of assets accounted for on a fair value basis can generate current period earnings without generating any associated cash flow from operating activities. A mismatch between earnings and cash flow from operating activities could have raised questions about the quality and sustainment of Enron's fair-value earnings; in other words, it could have created uncertainty over whether those earnings ultimately would convert into cash. Enron turned to structured-finance transactions to make proceeds from financings appear as cash from operating activities and thereby balance its earnings with its cash flow from operating activities.

Specifically with respect to Citigroup, Enron executed Project Nahanni, Project Bacchus ("Bacchus"), and ten so-called prepay transactions to meet its financial reporting needs.

As Citigroup knew, because it helped structure the transaction, the purpose of Project Nahanni was to generate cash from operating activities by selling Treasury bills ("T-bills") bought with the proceeds of a loan. The transaction took place over approximately five weeks spanning Enron's 1999 fiscal year end. The project was structured as a business partnership between Enron and an "investor" entity arranged by Citigroup to engage in this transaction. The investor entity was capitalized with a $485 million loan from a Citigroup affiliate and $15 million in equity contributed by a third party. The idea was that the "investor" entity would turn its capitalization into T-bills and contribute those T-bills into a partnership with Enron. The partnership would sell the T-bills (classified by Enron as "merchant investments"), thus generating cash flow from operating activities. Enron would consolidate the partnership's results on its financial statements and report the proceeds of T-bill sales as cash from operating activities on its consolidated statement of cash flows. The partnership was created in mid-December 1999. On

December 29, 1999, Enron used this structure to increase its reported cash from operating activities by $500 million. Enron informed Citigroup that it would use this $500 million to decrease its reported debt by that amount. Three weeks later, in January 2000, Enron arranged to repay the $485 million loan in full with interest. Enron's purported disclosure of this transaction in its year-end 1999 filings failed to disclose fully that the partnership was created in December to fund a transaction that lasted just long enough to achieve a year-end financial reporting effect. Enron's disclosure was also misleading because it created the false impression that this transaction related to Enron's regular-course-of-business investments in energy and technology companies.

Project Bacchus was structured by Enron as a sale of an interest in certain of its pulp and paper businesses to a special purpose entity ("SPE") capitalized by Citigroup with a $194 million loan and $6 million in equity. Citigroup understood that the $6 million in equity represented the three percent minimum capital investment by an independent, third party (here, Citigroup) considered necessary under the then existing accounting literature to avoid consolidating this entity with Enron for accounting purposes. (To protect Citigroup's loan, Enron and the entity entered into a total return swap, the effect of which was to make Enron responsible for paying Citigroup an amount equal to the principal and interest on the $194 million loan.) Enron and Citigroup signed documents that supported Enron's accounting treatment. Simultaneously, however, Citigroup obtained oral representations from Enron that Citigroup would not lose money in connection with its three percent equity investment. Citigroup understood that reducing this representation to a written contractual term would have negated Enron's accounting treatment. Consequently, in substance, Citigroup was not at risk for its equity investment, thus rendering Project Bacchus a $200 million financing from Citigroup, which should have been accounted as such. At the end of December 2000, Project Bacchus generated $200 million of cash from operating activities and $112 million in pre-tax income for Enron. Four months before Project Bacchus' maturity date, the Project Bacchus structure was terminated and the pulp and paper assets were moved into a different structure involving Enron and Citigroup.[4]

The prepay transactions, as Citigroup understood, were financings structured as commodity trades.[5] Nominally, these transactions involved upfront cash payments (prepayments) to Enron in exchange for Enron's obligation to make future payments determined by multiplying the spot price of the referenced commodity by the contract volume. However, the structure effectively passed the commodity price risk back to Enron. If all the contracts were performed pursuant to their terms, Citigroup was entitled to receive repayment of its prepayment of the contract price, together with a negotiated return on that amount, on a specified schedule — *i.e.*, the equivalent of an interest payment on the contract price. The negotiated return was unrelated to any price risk associated with owning a commodity contract. As Citigroup knew, Enron reported the receipt of cash generated from prepay transactions as cash flow from operating activities, rather than cash flow from financing activities, and it reported its repayment obligation as a price risk management liability, rather than debt. In net economic effect, Enron used these transactions to borrow, over a two and one-half year period, an aggregate amount of $3.8 billion (although at any particular point in time the amount of Enron's outstanding obligations was lower).

During fiscal year 1998, $500 million out of $1.6 billion that Enron reported as net cash flow from operating activities on its consolidated statement of cash flows came from prepay transactions with Citigroup. During fiscal year 1999, the Project Nahanni and prepay structured transactions accounted for approximately $2 billion of Enron's reported net cash flow from operating activities. But for these transactions, in that year, Enron would have reported that it used $800 million in net cash in operating activities (a negative amount in its statement of cash flows) instead of reporting that it generated $1.2 billion in net cash from operating activities (a positive amount in its statement of cash flows). For fiscal 2000 the Bacchus and prepay structured transactions accounted for approximately $1 billion of $4.7 billion net cash generated by operating activities. For the second quarter of 2001 prepay structured transactions accounted for approximately $1 billion of $1.3 billion that Enron reported as net cash flow used in operating activities. But for the prepay structured transactions reported net cash flow used in operating activities (a negative amount in the statement of cash flows) would have been $2.3 billion.[6]

Citigroup knew or should have known that the acts or omissions described in this Order would contribute to Enron's violations of Exchange Act Section 10 (b) and Exchange Act Rule 10b-5. Consequently, Citigroup was a cause of Enron's violations within the meaning of Exchange Act Section 21C.

2. Dynegy Inc.

Dynegy also turned to a structured-finance transaction to address the mismatch between its earnings and operating cash flow resulting from fair value accounting for trading-related contracts and financial instruments. Dynegy, too, was concerned that the mismatch between earnings and cash flow from operations would raise questions about the quality of Dynegy's earnings and its ability to sustain those earnings. In addition, Dynegy sought to lower its effective tax rate through a transaction-based tax benefit.

Project Alpha ("Alpha") was a complex financing, structured as a two-phase long-term natural gas contract. The transaction was conceived and marketed to Dynegy by Dynegy's then auditor-consultant; Citigroup's role was to raise the financing and assist in facilitating the transaction. As Citigroup understood, essentially, Alpha was a loan to Dynegy, pursuant to which Dynegy purchased gas at a discount from a sponsored SPE during the initial nine months of Alpha's five-year term and then sold the gas for a profit; Dynegy is currently repaying the loan, with interest, over the remaining 51 months by purchasing gas at above-market prices from the SPE. The commodity price and interest rate risks associated with the loan repayment are hedged through a series of derivative transactions. Citigroup knew that Dynegy used Alpha to borrow a total of $300 million and generate a $79 million tax benefit. As Citigroup also knew, Dynegy recorded the Alpha-derived loan proceeds in its statement of cash flows as operating cash flow.

In fiscal year 2001, Alpha accounted for $300 million of Dynegy's reported cash flow from operating activities, out of a gross reported figure of $811 million. The Alpha-related cash flows represented 37 percent of Dynegy's reported operating cash flow. The Alpha-based $79 million tax benefit comprised 12 percent of 2001 Dynegy's net income.

Citigroup knew or should have known that the acts or omissions described in

this Order would contribute to Dynegy's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Consequently, Citigroup was a cause of Dynegy's violations within the meaning of Section 21C of the Exchange Act.

B. Respondent

Citigroup, Inc.

Citigroup is a Delaware corporation with its principal place of business in New York, New York. Citigroup is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumer and corporate customers. At all times pertinent to this Order, the common stock of Citigroup was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange under the symbol "C".

C. Issuers

1. Enron Corp.

Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. At all times pertinent to this Order, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange under the symbol "ENE".

Until its bankruptcy filing in December 2001, Enron was the seventh largest corporation in the United States based on reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. The Company also created and traded financial products.

2. Dynegy Inc.

Dynegy is an Illinois corporation headquartered in Houston, Texas.[7] At all times pertinent to this Order, the common stock of Dynegy was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange under the symbol "DYN".

Dynegy produces and delivers energy, including natural gas, electricity, natural gas liquids, and coal, to customers in North America, the United Kingdom, and Continental Europe. In addition to energy production and delivery, energy trading was a key component of Dynegy's business during the relevant period.

D. Discussion

1. Enron-Related Conduct

Project Nahanni

At a September 1999 meeting between Enron and Citigroup, Enron explained that it projected a year-end shortfall in its cash flow from operating activities because of a delay in a sale of one of its merchant investments. Enron indicated to Citigroup that it wanted to develop and execute a transaction with Citigroup before the year end to generate cash flow from operating activities to make up for the shortfall.

Citigroup developed Project Nahanni and presented it to Enron as a financial statement solution to that operating cash flow shortfall. The basic concept behind Project Nahanni was to generate cash flow from operating activities by selling T-bills bought with the proceeds of a loan arranged by Citigroup, using a minority interest structure. In this structure, a third party provides capital by acquiring a minority interest in a consolidated subsidiary of a sponsor. Accordingly, cash flow associated with the activities of the consolidated subsidiary appears as cash flow from operating activities on the sponsor's financial statements. The third party's financial contribution to the consolidated subsidiary appears as a minority interest on the sponsor's balance sheet, rather than debt. Here, Citigroup fashioned a structure whereby an investor entity would purchase T-bills primarily with proceeds of a loan. The investor entity would then use those T-bills to acquire a minority interest in a consolidated subsidiary of Enron created specifically to effectuate this transaction. The Enron subsidiary would then sell the T-bills. The sale of the T-bills, in turn, would generate cash that would appear as cash from operating activities on Enron's statement of cash flows.

In addition, Enron told Citigroup that it would use the proceeds of this transaction to pay down certain of its debt obligations. In effect, in addition to increasing its reported cash flow from operating activities, Enron intended to use Project Nahanni to improve its reported debt to equity ratio by replacing debt with a minority interest in a consolidated subsidiary.

More specifically, the Project Nahanni transaction was structured as follows: The consolidated subsidiary of Enron that sold the T-bills was a partnership called Marengo Assets, L.P. ("Marengo"). Marengo was a partnership between Enron and an entity called Nahanni Investors L.L.C. ("Nahanni"). Enron was the general partner of Marengo. For its general partner interest, Enron contributed $400 million in Enron unsecured interest-bearing notes and $100 million worth of preferred stock in one of Enron's wholly owned subsidiaries. Nahanni was the limited partner of Marengo. Nahanni was arranged by Citigroup to act as the third party, minority interest investor in this transaction. Citigroup arranged for Nahanni to be capitalized with a $485 million loan[8] and a $15 million investment by a third party.[9] In order to execute a cash-less transaction with Marengo, Nahanni used its cash capitalization to buy T-bills and contributed $500 million worth of T-bills into Marengo in exchange for its partnership interest.[10] As the general partner, Enron consolidated Marengo into its financial statements: Marengo's sale of T-bills appeared as cash flow from operating activities on Enron's consolidated statement of cash flows.[11]

The principal and interest on the loan to Nahanni were indirectly paid by Enron via Nahanni's partnership interest in Marengo. The Marengo Partnership Agreement required Marengo to make payments to Nahanni in amounts and at times corresponding to Nahanni's payment obligations under its loan. Project Nahanni's structure contemplated that assets contained in Marengo would generate sufficient proceeds to cover interest on the loan to

Nahanni, Nahanni's operating expenses, and the current return to the third-party equity investors in Nahanni.

Although Enron used the Project Nahanni structure only once, at year-end 1999, it was available to be used each year at Enron's option for up to the entire five-year term. The loan to Nahanni was revolving. In any one year, Enron could redeem up to $485 million of Nahanni's interest in Marengo, thereby causing Nahanni to repay the portion of its loan representing the redeemed interest.[12] Thereafter, Enron could cause Nahanni to draw on Nahanni's revolving loan by calling upon Nahanni to make a capital contribution to Marengo. By operation of the revolving loan agreement, any such capital contribution would be limited to an amount representing any previously redeemed Nahanni interest in Marengo (up to $485 million). Nahanni and Marengo were specifically prohibited from engaging in any other business or activity.

As originally contemplated, Enron could withdraw the proceeds of the T-bill sales by borrowing from Marengo, after contributing into Marengo sufficient assets to assure eventual redemption of Nahanni's interest. (Since Enron consolidated Marengo, any such loan would be eliminated in consolidation, *i.e.*, it would be an unreported inter-company loan.) Alternatively, the cash proceeds would remain in Marengo or could be used to effectuate the repayment of the $485 million Nahanni loan by partially redeeming Nahanni's interest in Marengo.

While the initiation of the transaction was designed to be reported as an increase in cash flow from operating activities, its wind-down was designed to be reported as a reduction in cash flow from financing activities. As noted, the repayment of the loan to Nahanni was triggered by the partial redemption of Nahanni's interest in Marengo. Generally, under GAAP, redemption of a partnership interest has to be reported as cash used for financing activity.

Nahanni was formed on December 17, 1999. The entire structure was put in place on December 21, 1999. On December 29, 1999, Enron generated — for financial statement purposes — $500 million in cash from operating activities by directing Marengo to liquidate all of its T-bills. Shortly before the transaction was to close, Enron's then-Treasurer informed Citigroup that Enron wanted access to the $500 million cash proceeds of the T-bill sales to pay down its outstanding debt. However, Enron did not post collateral that was acceptable to Citigroup. Instead, Citigroup agreed to make some modifications to the structure that allowed Enron to borrow the $500 million from Marengo, provided that Enron obtained a letter of credit from a highly rated financial institution to guarantee the $500 million loan. The term of the loan could not exceed the term of the letter of credit that Enron obtained. Enron provided a letter of credit expiring on January 24, 2000, and borrowed the $500 million. Since the transaction with Marengo was an inter-company loan and was eliminated in consolidation, Enron was able to reduce, at year-end, its reported debt by $500 million.

On January 24, 2000, Enron drew on the letter of credit and repaid the $500 million loan from Marengo, with interest. Enron then caused Marengo to partially redeem Nahanni's limited partnership interest. To do so, Marengo paid Nahanni approximately $487.1 million, representing $485 million in principal borrowed by Nahanni on the revolving loan and approximately $2.1

in interest.[13]

At year-end 1999, Enron reported in its Statement of Cash Flows an increase of approximately $1.2 billion in cash flow from operating activities. The $500 million Project Nahanni transaction accounted for 41 percent of that amount.

Project Bacchus

In December 2000, Enron recorded a $112 million gain on a $200 million sale to Citigroup of an equity interest in certain entities holding pulp and paper assets. This transaction, referred to as Project Bacchus, was purportedly effected as a Statement of Financial Accounting Standards No. 125 ("SFAS 125") transaction.[14] Enron had executed similar SFAS 125 transactions with other financial institutions. In asking Citigroup to execute Project Bacchus, Enron provided template transaction documentation for the deal.

Under the circumstances of this particular transaction, Enron had to transfer control of the subject asset to an entity in which a third party had made a minimum three percent equity investment.[15] Enron transferred an equity method investment in an entity it created to hold an interest in its pulp and paper assets to an SPE called the Caymus Trust ("Caymus") though a multi-layered structure. Caymus was capitalized with a Citigroup loan for $194 million and $6 million of equity contributed by another financial institution. Although this institution made the equity contribution, it transferred the equity risk to Citigroup in a total return swap. Citigroup was required under GAAP to be at risk for its $6 million equity investment in Caymus throughout the transaction. Citigroup's debt contribution was protected by a total return swap between Caymus and Enron that effectively required Enron to pay Citigroup, through Caymus, a fixed amount of cash equal to principal and interest on the $194 million debt portion. In return, Enron received a return based on the value of the equity interest in the pulp and paper assets subject to the transaction. The transaction was given a nine-month term, at which time the assets Enron transferred to Caymus were to be sold.

Citigroup signed written agreements that were drafted to allow Enron to achieve sale treatment pursuant to SFAS 125. Simultaneously, Citigroup received oral representations from Enron that it would not lose money in connection with its equity investment. Citigroup understood that reducing this representation to a written contractual term would have negated Enron's accounting treatment. In addition, to induce Citigroup to enter into the transaction, Enron indicated that it would take Citigroup out of the transaction well before the expiration of its nine-month term. (In fact, four months before Project Bacchus' maturity date, Enron and Citigroup formed a joint venture that purchased Citigroup's interest in Project Bacchus.[16])

In substance, Enron was economically at risk for 100 percent of the assets as a result of Enron's oral commitment regarding Citigroup's three percent equity investment and by application of the total return swap. Citigroup, on the other hand, contributed $200 million in cash in return for repayment of that amount with interest. In economic reality, therefore, Bacchus was a $200 million financing structured as a sale for the sole purpose of allowing Enron to characterize its proceeds as cash flow from operating activities[17] and to record a gain of $112 million.[18]

Project Bacchus accounted for four percent of Enron's reported cash flow from operating activities for year-end 2000 and 11 percent of its net pre-tax income.

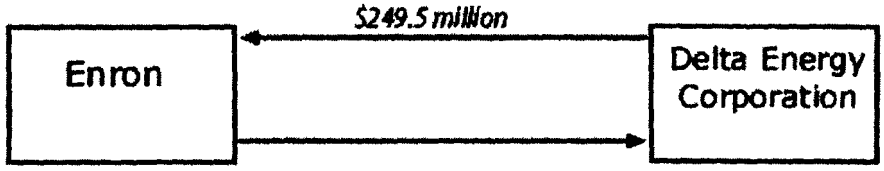
Prepay Transactions

As noted, the prepay transactions were financings structured as commodity trades so that their proceeds could be reported by Enron on its statement of cash flows as cash flow from operating rather than financing activities. To accomplish this objective, prepays were structured as three sets of separate transactions among Enron, Citigroup, and a third party. (In some cases, the third party was an established financial institution; in other cases, the third party was Delta Energy Corporation ("Delta"), which was a Citigroup-sponsored special purpose vehicle.) Each set of these separate transactions purported to transfer commodity risk. When all the contracts were taken together, however, the net effect was that Enron received an up-front cash payment from Citigroup and Citigroup was entitled to receive repayment of this sum, together with a set negotiated return, on a specified schedule (*i.e.*, the equivalent of a fixed interest rate). The negotiated return was unrelated to any price risk associated with owning a commodity contract. (The third parties received a nominal fee, paid by Enron, for participating in the transaction.) Enron reported the cash it received from prepay transactions as cash flow from operating activities, rather than cash flow from financing, and it reported its repayment obligation as price risk management liability, rather than debt.

In all, Citigroup and Enron executed ten prepay transactions between December 1998 and June 2001. In all of these transactions, Citigroup was aware that Enron's primary motive was to receive cash financings, but characterize the proceeds from the transactions on its financial statements as cash from operating (instead of financing) activities. Through these ten prepay transactions, Citigroup made available to Enron a total of $3.8 billion over a two and one-half year period (although at any particular point in time, the amount of Enron's outstanding obligations was lower).

In its simplest form, the structure of the Enron-Citigroup prepay transactions involved three separate swap agreements: between Enron and a third party; the third party and Citigroup; and Citigroup and Enron. The following illustrates the operation of this structure in the context of a $249.5 million Enron-Citigroup prepay transaction executed in June 2001.

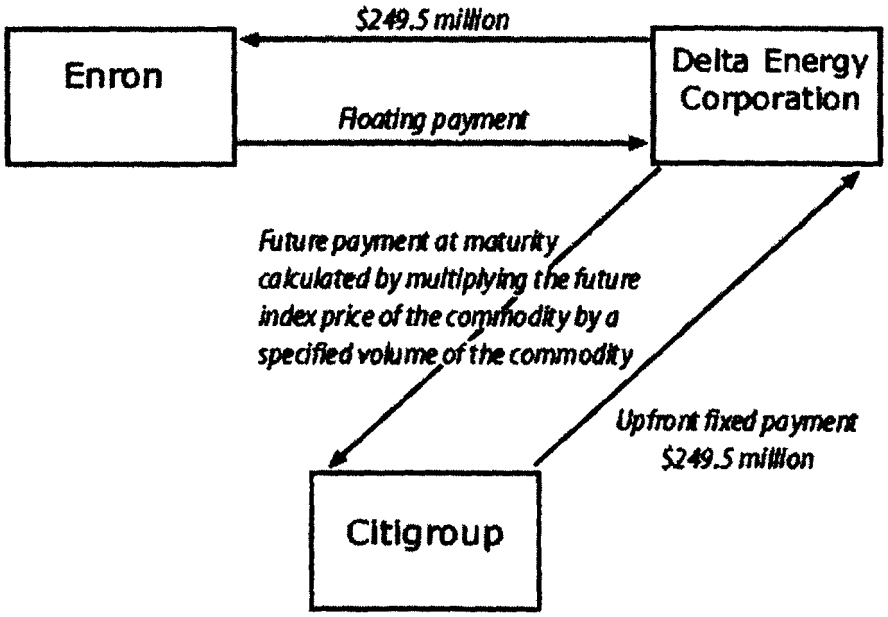
Leg 1: Enron — Delta Swap



- In this leg of the transaction, in exchange for an upfront cash payment, Enron agreed to pay Delta an amount determined by multiplying the future index price of the referenced commodity by the contract volume. The amount of the future payment from Enron to

Delta "floated" with variations in the future index price (known as the "spot price"). If the spot price fell below a certain level, under the terms of the agreement, Delta would be entitled to less than its $249.5 million upfront payment. However, as illustrated below, this price risk was eliminated through another simultaneous transaction.

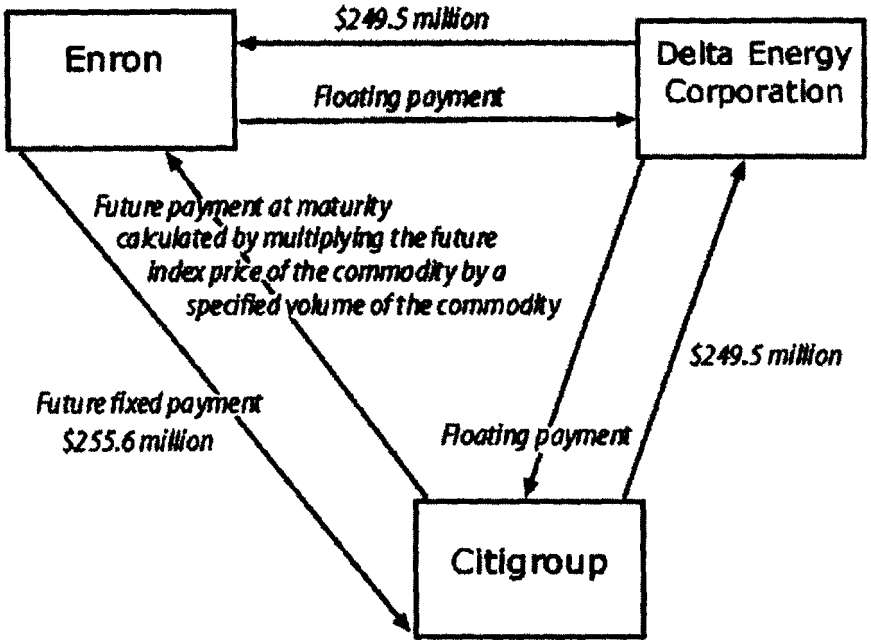
LEG 2: Delta — Citigroup Swap



- In this leg, in connection with the prepay transaction, Citigroup funded the Delta payment to Enron. Citigroup made a $249.5 million upfront payment to Delta on June 28, 2001 — the same day that Delta made its $249.5 million upfront payment to Enron.

- Delta's commodity price risk was passed through to Citigroup: the future floating payment from Enron to Delta exactly mirrored the future floating payment from Delta to Citigroup (*i.e.*, same amounts and payment schedule).

Leg 3: Citigroup — Enron Swap



- In this leg, Enron agreed to pay Citigroup $255.6 million six months after June 28, 2001.

- Citigroup, in turn, passed the commodity price risk back to Enron.

Overall, the substance of the transaction was that Citigroup funded a $249.5 million disbursement to Enron and six months later Enron was obligated to repay Citigroup $255.6 million — an approximate five percent return to Citigroup exclusive of its arrangement fee. The future floating payment from Enron to Delta, Delta to Citigroup, and Citigroup to Enron exactly mirrored each other (*i.e.*, same amounts and payment schedule) — canceling each other out. The combined operative effect of the three agreements was to pass the commodity price risk back to Enron.[19]

The third party in many of these transactions, Delta, was a nominally capitalized SPE established by Citigroup, whose sole purpose in these transactions was to facilitate Enron's accounting treatment.[20] Delta had no material independent resources available to engage in commodity trades. The only transactions that Delta participated in were those transactions that Citigroup asked it to execute and for which funding was provided by Citigroup. For the relevant transactions, Citigroup and Enron prepared the necessary documentation for Delta's signature. Moreover, whenever Enron needed to communicate with Delta (*e.g.*, when Enron needed Delta to provide certain written representations for its auditors), Enron contacted Citigroup.[21]

Further, in certain of these transactions, Citigroup requested cross-default provisions so that if Enron defaulted on the Enron-Delta leg of the prepays, all of the legs would collapse simultaneously. Enron advised Citigroup that its auditors would not permit cross-default provisions in which documents relating to one leg of the transaction would specifically reference other legs

of the transaction. Citigroup satisfied Enron's auditors' concerns by structuring certain more generalized termination provisions that would ensure termination of all legs of the transactions in case Enron defaulted.

Finally, the amount of the commodity subject to a prepay was based on the amount Enron wanted to borrow. That amount was determined by taking the principal amount required by Enron, adding interest for the number of days the transaction was to last, and dividing that sum by the per-unit price of the referenced commodity.

The Yosemite Transactions

In the beginning of 1999, Citigroup and Enron created a way for Enron to use the domestic and foreign capital markets to fund its prepay transactions. At this time, Enron was looking to move some of its financings into the capital markets to free up its capacity to borrow from banks. Citigroup welcomed a structure that would maintain its banking relationship with Enron without increasing its credit exposure.

The structure, called Project Yosemite, accomplished this goal by using proceeds of sales of privately placed notes to fund blind pool trusts that either funded prepay transactions or served as security for Citigroup's funding of prepay transactions.[22] Specifically, Citigroup underwrote and privately placed certain notes with large sophisticated investors. The proceeds of those notes were deposited in trusts that were allowed to make certain permitted investments. These permitted investments could have taken a variety of forms generally consisting of highly rated securities or bank deposits, and certain obligations of Enron. The trusts were set up such that Citigroup made the periodic interest payments on the notes. In turn, Citigroup received the returns on permitted investments.

Citigroup also entered into credit default swaps with the trusts whereby, in case of an Enron bankruptcy, Citigroup would deliver to the note holders senior unsecured obligations of Enron and Citigroup would receive the trust investments. In the first two structures, the trusts invested in prepay transactions by replacing Citigroup as the source of Delta's funding. In the later variation of this structure, Citigroup funded the prepays and the trusts invested in highly rated bank deposits. In this iteration of the structure, Citigroup's extension of credit to Enron under the prepay arrangement was fully secured with highly rated bank deposits by operation of the credit default swap with the relevant trust. Using the Yosemite structure, Enron and Citigroup raised approximately $2.3 billion in the capital markets, which provided the financing for additional Enron-Citigroup prepay transactions.

The effect of the prepay transactions involving Enron and Citigroup on Enron's statement of cash flows for the relevant periods were as follows:[23]

For the year ended December 31, 1998, prepay transactions totaling approximately $500 million increased reported net cash purportedly *generated* by operating activities from $1.1 billion to $1.6 billion. For the second quarter of 1999, a prepay transaction totaling approximately $250 million reduced reported net cash reportedly *used* in operating activities from ($288) million to ($38) million. For the third quarter of 1999, a prepay transaction totaling approximately $337 million reduced reported net cash

purportedly *used* in operating activities from ($380) million to ($43) million. For the year ended December 31, 1999, prepay transactions totaling approximately $904 million increased reported net cash purportedly *generated* by operating activities from $296 million to $1.2 billion. For the first quarter of 2000, a prepay transaction totaling approximately $305 million reduced reported net cash purportedly *used* in operating activities from ($762) million to ($457) million. For the third quarter of 2000, a prepay transaction totaling approximately $475 million made it appear as if Enron *generated* $100 million rather than *used* ($375) million in reported net cash in its operating activities. For the second quarter of 2001, prepay transactions totaling approximately $1 billion reduced reported net cash purportedly *used* in operating activities from ($2.3) billion to ($1.3) billion.

2. Dynegy-Related Conduct

Project Alpha

In 2000, Citigroup marketed to Dynegy Enron-style prepay transactions. Although interested in the prepays, Dynegy concluded that a competing transaction under consideration by Dynegy's tax department offered Dynegy superior benefits. Dynegy selected that transaction — which became known as Project Alpha. In its final form, Alpha was a complex financing structured to achieve joint tax and financial statement benefits. Dynegy turned to Citigroup to (i) arrange Alpha's financing and the equity contribution of a Dynegy-sponsored SPE; (ii) provide a portion of Alpha's financing; and (iii) participate as a party in a number of Alpha-supporting derivative transactions.

Project Alpha involved, in essence, a $300 million loan to Dynegy. Dynegy would benefit from the loan by receiving cash up-front, and by recording the loan proceeds, for accounting purposes, as cash flows from operating activity — the purchases and sales of natural gas. The $300 million flowed to Dynegy at Alpha's inception in April 2001; Dynegy is currently repaying the loan, along with a negotiated return, and will continue to do so through the end of Alpha's five-year term. The natural gas component of Alpha unfolds in two phases: in the first phase — the initial nine months of Alpha — Dynegy purchased gas from an SPE at below-market prices and then sold the gas into the market for a profit. In Alpha's second phase — the remaining 51 months of Alpha's five-year term — Dynegy is repaying the loan, along with the negotiated return, by purchasing gas from the SPE at above-market prices. The commodity price and interest rate risks associated with the loan repayment are hedged through a series of complex derivative transactions.

Alpha was designed to address the disconnect between Dynegy's operating cash flow and net income — a consequence of mark-to-market accounting. Consistent with this purpose, and despite Alpha's financing nature, Dynegy recorded as operating cash flow in its 2001 Form 10-K the Alpha-derived $300 million, comprising 37 percent of Dynegy's total 2001 operating cash flow.

Alpha also provided a $79 million increase, in 2001, to Dynegy's net income. The increase, flowing from a tax benefit built into the Alpha transaction, hinged on two factors. First, to recognize the benefit, Dynegy was required to demonstrate a "non-tax business purpose." This took the form of Dynegy's use of Alpha to redress the "disconnect," by enabling Dynegy to

record $300 million in operating cash flow. Second, Dynegy recognized the $300 million "losses" Alpha would generate in its latter phase and used it as an offset against its 2001 income, garnering thereby the $79 million net income enhancement, comprising 12 percent of Dynegy's total 2001 net income.

Dynegy's ultimate restatement, negating Alpha's $300 million operating cash flow benefit, also negated the $79 million net income enhancement. Accordingly, Dynegy restated its financial statements to reverse the net income enhancement. Citigroup was aware of Dynegy's purpose in conducting Alpha, and was aware of Alpha's anticipated accounting treatment. Citigroup was also aware that Dynegy sought to achieve a large Alpha-based net income enhancement through the Alpha-linked tax benefit.

Citigroup arranged Alpha's $300 million funding by assembling a syndicate of approximately eight institutional lenders and then establishing a mechanism for the syndicate's funding of Alpha in the form of a "Credit-Linked Note" ("CLN") structure. By means of the CLN structure, Dynegy accomplished the funding of Alpha without incurring any obligation to explain the various components of Alpha's complex structure to the syndicate members.[24] In addition to arranging the lending syndicate, Citigroup facilitated Alpha by other means: by participating in the syndicate through contribution of $60 million of Citigroup's own funds to Alpha's financing; by assisting in hedging market risk to the lending syndicate through direct participation, as a party, in the Alpha hedge transactions; by helping attract certain financial institutions to make the requisite equity investment in the gas-trading SPE; by arranging for the physical supply of gas to the SPE, for purchase by Dynegy; and, finally, by participating in the drafting of the Alpha-related contracts and schedules.

Alpha can be conceptualized as a flow-through matrix involving two SPEs, three interconnected loans, a gas purchase agreement, hedging transactions, and a linked tax benefit. The first Alpha "loan" took the form of a $300 million capital contribution by an SPE, NGAI Funding, L.L.C. ("NGAI Funding"), to a limited partnership, DMT Supply — a gas trading partnership. NGAI Funding's source of funding for its loan to DMT Supply was the Citigroup-assembled lending syndicate. The second Alpha "loan" essentially routed to Dynegy the proceeds of the first loan. Specifically, DMT Supply loaned $300 million to Dynegy, payable by Dynegy upon demand of DMT Supply. By Alpha's April 2001 inception, Dynegy had received, indirectly, $300 million from the lending syndicate.

The other integral component of Alpha was a five-year gas purchase contract ("Gas Contract") between DMT Supply (later subsumed by Dynegy) and the second Alpha SPE, ABG Gas Supply L.L.C. ("ABG Supply"). The Gas Contract is the mechanism for repaying the syndicate of lenders its $300 million loan to Dynegy. Pursuant to the Gas Contract, which commenced in April 2001, DMT Supply bought natural gas from ABG Supply at *below-market* prices for the first nine months of the Gas Contract — for re-sale by DMT Supply on the open market at a profit.

DMT Supply used the gas sale profits, approximately $300 million, generated during the first nine months of the Gas Contract to repay its loan to NGAI Funding, which, in turn, funneled the money back to the lending syndicate. However, the lending syndicate did not at that point remove itself from the

transaction with its $300 million intact. Instead, it re-circulated the $300 million, in the form of a third Alpha "loan," consisting of monthly advances to ABG Supply over the first nine months of Alpha, to subsidize the losses ABG Supply sustained over those first nine months in selling gas to DMT Supply at a pre-determined $300 million discount. Consequently, nine months into Alpha, the status of the transacting parties was as follows: Dynegy retained the $300 million it had received, indirectly, from the lending syndicate at Alpha's inception; DMT Supply had repaid its $300 million "loan" from NGAI Funding, which, in turn, forwarded the $300 million to the lending syndicate; ABG Supply had "borrowed" from the lending syndicate the $300 million the syndicate had received back from NGAI Funding, to subsidize ABG Supply's $300 million losses over Alpha's first nine months; and the lending syndicate was still owed the $300 million it loaned to ABG Supply.

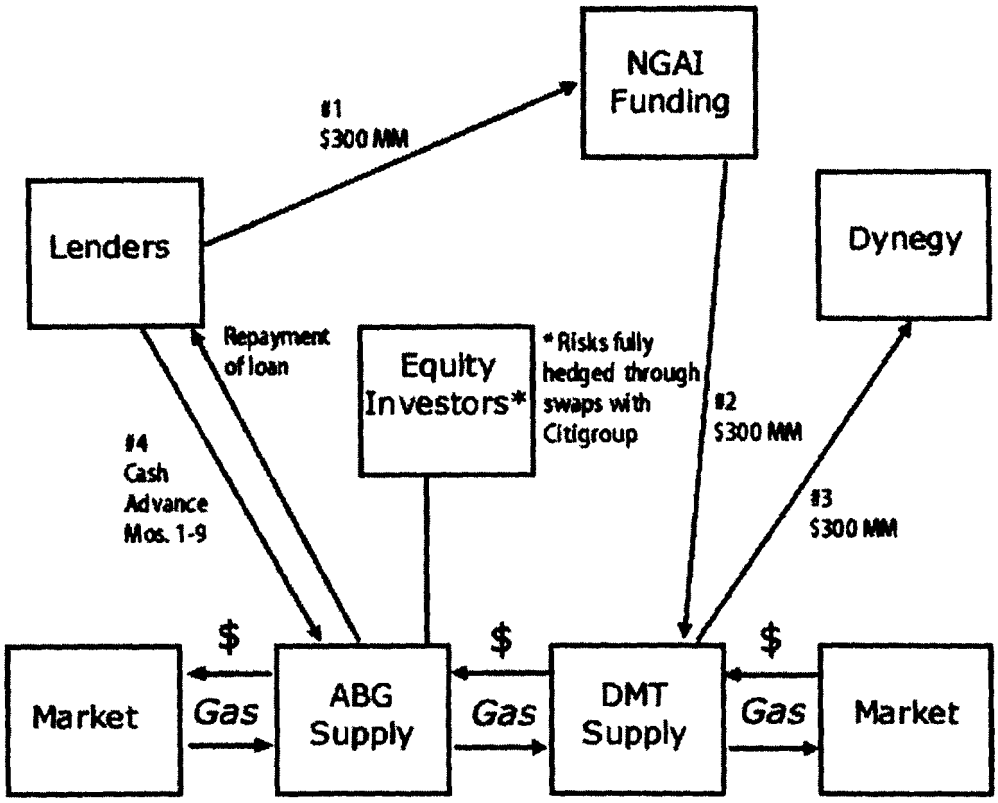
ABG Supply is repaying the loan from the lending syndicate over Alpha's remaining 51 months. ABG Supply is accomplishing this by selling gas to Dynegy at a pre-determined $300 million total premium above the market price, generating $300 million in losses to Dynegy by the end of Alpha's five-year term, and $300 million in profits to ABG Supply. ABG Supply will then transmit its profits over this second phase of Alpha to the lending syndicate, thereby satisfying ABG Supply's $300 million debt to the syndicate.[25]

Dynegy's treatment of the Alpha cash flow as operating cash flow did not conform to GAAP. Under Financial Accounting Standard 95 ("FAS 95"), the cash flow associated with Alpha should have been classified as cash flow from financing activities — not operations.[26] The Alpha proceeds should have been classified as cash flow from financing activities for two additional reasons.

First, the owners of ABG Supply did not maintain at risk at least 3 percent of their equity investment in ABG Supply. In fact, as part of the transaction, the owners of ABG Supply avoided *all* commodity price risk by engaging in hedging transactions with Citigroup. Consequently, ABG Supply, as an SPE, should have been consolidated with Dynegy in Dynegy's financial statements, and the syndicate's $300 million loan to ABG Supply — covering ABG Supply's losses during the first nine months of the Gas Contract — should have been reflected by Dynegy, on a consolidated basis, as cash flow from financing.[27] Second, Citigroup was a party in the "middle" of various back-to-back swap transactions with ABG Supply's parent holding company and Dynegy (the "swap counter parties"). These swap transactions included, at Citigroup's insistence, cross-termination provisions that relieved Citigroup of the obligation to perform in the event of default by either swap counter party.[28] The cross-termination provisions were also indicative of a financing, requiring Dynegy to record the Alpha-based proceeds as cash flow from financing, not operations.

The following diagram illustrates the flow of Alpha loan proceeds.

Project Alpha



During the first 9 months, DMT Supply purchased gas from ABG Supply at below-market prices. During months 10 - 60, the lenders are repaid through above-market purchases by DMT Supply.

3. Legal Analysis

Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 prohibit, *inter alia*, engaging in a "course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Throughout the period described in this Order, Enron and Dynegy structured certain transactions whose purpose and effect was, among other things, to present the proceeds of these transactions as cash flow from operating activities when in economic reality they were proceeds of financing activities. Enron and Dynegy also did not disclose that these transactions were financings. As a result, Enron's and Dynegy's reported results of operations and financial condition presented a more favorable picture than was the case. Specifically, among other things, Enron's and Dynegy's financial statements overstated Enron's and Dynegy's cash flows from operating activities and understated the amount of cash Enron and Dynegy had received in financing transactions from financial institutions. Additionally, Enron's and Dynegy's financial statements overstated their net incomes. As a further consequence of these transactions, neither Enron's and Dynegy's balance sheets nor their disclosures reflected all of the companies' obligations that were in the nature of debt. Enron and Dynegy engaged in this conduct, among other reasons, in order to maintain and increase the market price of their securities.

Section 21C of the Exchange Act provides that a person is a "cause" of

another's violation if the person "knew or should have known" that his or her acts or omissions would contribute to such a violation. Citigroup knew or should have known that its conduct would contribute to Enron's and Dynegy's violations of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5. Section 21C(e) of the Exchange Act authorizes the Commission to order Citigroup to disgorge any fees associated with its unlawful conduct.

IV.
Findings

Based on the foregoing, the Commission finds that Citigroup knew or should have known that the acts or omissions described in this Order would contribute to Enron's and Dynegy's violations of Exchange Act Section 10(b) and Exchange Act Rule 10b-5. Consequently, Citigroup is a cause of Enron's and Dynegy's violations within the meaning of Exchange Act Section 21C.

V.
Acceptance of Citigroup's Offer of Settlement

Citigroup has made an Offer of Settlement in order to resolve fully the Commission's investigation of Citigroup's involvement in executing structured finance transactions with Enron and executing Project Alpha with Dynegy.

In determining to accept the Offer, the Commission considered certain remedial acts undertaken by Citigroup. Specifically, in August 2002, Citigroup initiated a series of policies and procedures that support the goal of greater transparency in the disclosure of structured finance transactions. Citigroup requires that all its public company clients commit to disclose promptly to the public the net effect of any financing transaction proposed to be executed by Citigroup if that transaction is material to the client and is intended not to be accounted for as debt on the client's financial statements. Citigroup has further instituted new guidelines for the use of special purpose vehicles and the use of tax-sensitive financial products. Citigroup has further taken steps to ensure that these new policies are implemented and carried out in a consistent manner by all business groups, and that senior management plays an ongoing role in monitoring compliance with these policies.

In determining to accept the Offer, the Commission also considered that Citigroup cooperated with the Commission's investigation in a timely and comprehensive manner, including production of witnesses and documents without delay, responsiveness to other requests for information, and timely efforts to resolve this matter.

VI.
Undertakings

In accepting Citigroup's Offer of Settlement in this matter, the Commission has taken into consideration, and is relying upon, Citigroup's express agreement to undertake to make the following payments:

A. Citigroup undertakes to make a payment of $48,500,000 as a penalty, in connection with its Enron-related conduct. This payment shall be available

for allocation in accordance with Section 308 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002) (hereinafter "Sarbanes-Oxley Act").

B. This payment, plus $52,750,000 in disgorgement and prejudgment interest, stemming from its Enron-related conduct, described in Section VII (B) below, shall be deposited in the Registry of the Court for the United States District Court for the Southern District of Texas by wire transfer or certified check made payable to Clerk, United States District Court, in the amount of $101,250,000. *See* Rule 611(b) of the Commission's Rule of Practice (hereinafter "Rule 611(b)") [17 C.F.R. Sec. 201.611(b)]. Such funds shall thereafter be distributed in the course of litigation pending in United States District Court for the Southern District of Texas, captioned *United States Securities and Exchange Commission v. Merrill Lynch Co., Inc., et al.*, Civil Action No. H-03-0946 (hereinafter "*SEC v. MLCO, et al.*"). Rule 611(b) [17 C.F.R. Sec. 201.611(b)]. Simultaneously, Citigroup shall transmit by facsimile or hand delivery to Andy Gould, Clerk's Office, United States District Court for the Southern District of Texas, a letter that describes the fact and purpose of the wire transfer or certified check, identifies the respondent Citigroup, and identifies the case name and number of *SEC v. MLCO, et al.* A copy of documentary proof of the wire transfer or certified check and a copy of the letter to Mr. Gould, shall be simultaneously transmitted by facsimile to Charles J. Clark, Assistant Director, Division of Enforcement, U.S. Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0703, (202) 942-9583 (facsimile).

C. Citigroup undertakes to make a payment of $9,000,000 as a penalty, in connection with its Dynegy-related conduct. This payment shall be available for allocation in accordance with Section 308 of the Sarbanes-Oxley Act.

D. This payment, plus $9,750,000 in disgorgement and prejudgment interest, stemming from its Dynegy-related conduct, described in Section VII (C) below, shall be delivered into the Registry of the Court for the United States District Court for the Southern District of Texas by a wire transfer or certified check made payable to Clerk, United States District Court, in the amount of $18,750,000. Rule 611(b) [17 C.F.R. Sec. 201.611(b)]. Such funds shall thereafter be distributed in the course of litigation pending in United States District Court for the Southern District of Texas, captioned *Securities and Exchange Commission v. Dynegy Inc.*, Civ. No. H-02-3623 (S.D. Tex. 2002) (hereinafter "Dynegy litigation"). Rule 611(b) [17 C.F.R. Sec. 201.611(b)]. Simultaneously, Citigroup shall transmit by facsimile or hand delivery to Andy Gould, Clerk's Office, United States District Court for the Southern District of Texas, a letter that describes the fact and purpose of the wire transfer or certified check, identifies the respondent Citigroup, and identifies the case name and number of the Dynegy litigation. A copy of documentary proof of the wire transfer or certified check and a copy of the letter to Mr. Gould, shall be simultaneously transmitted by facsimile to Spencer Barasch, Associate District Administrator, Division of Enforcement, U.S. Securities and Exchange Commission, Burnett Plaza, Suite 1900, 801 Cherry Street, # 18, Fort Worth, TX 76102-6882, (817) 978-2700 (facsimile).

E. Citigroup represents that each of the amounts to be paid pursuant to the Order is not a specific corpus or separate identifiable asset derived from Citigroup's transactions with Enron, and will be paid out of the general corporate funds of Citigroup. Citigroup further represents that this

settlement shall not release or impair the claims, if any, that any other person or entity may have against Citigroup and its affiliates, nor shall this settlement constitute evidence of or any admission by Citigroup or its affiliates as to the validity or amount of any such claims.

VII.
Order

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Citigroup.

ACCORDINGLY, IT IS HEREBY ORDERED, that:

A. Citigroup is hereby ordered pursuant to Section 21C of the Exchange Act to cease and desist from committing or causing, within the meaning of Exchange Act Section 21C, any violation of, and any future violations of, Exchange Act Section 10(b) and Exchange Act Rule 10b-5;

B. Citigroup is hereby ordered pursuant to Section 21C(e) of the Exchange Act to pay disgorgement and prejudgment interest, stemming from its Enron-related conduct, in the amount of $52,750,000. Immediately upon entry of this Order, Citigroup shall deliver this payment into the Registry of the Court for the United States District Court for the Southern District of Texas in accordance with the procedures described in Section VI(B) above. In accordance with Rule 611(b) [17 C.F.R. Sec. 201.611(b)], the procedures set forth in Section VI(B) above shall govern the distribution of any funds paid in accordance with this Order, rather than the general provisions set forth in Rules 610 through 620 [17 C.F.R. Sec. 201.610 through 620];

C. Citigroup is hereby ordered pursuant to Section 21C(e) of the Exchange Act to pay disgorgement and prejudgment interest in the amount of $9,750,000, stemming from its Dynegy-related conduct. Immediately upon entry of this Order, Citigroup shall deliver this payment into the Registry of the Court for the United States District Court for the Southern District of Texas in accordance with the procedures described in Section VI(D) above. In accordance with Rule 611(b) [17 C.F.R. Sec. 201.611(b)], the procedures set forth in Section VI(D) above shall govern the distribution of any funds paid in accordance with this Order, rather than the general provisions set forth in Rules 610 through 620 [17 C.F.R. Sec. 201.610 through 620].

By the Commission.

Jonathan G. Katz
Secretary

Endnotes

[1] The findings herein are made pursuant to the Offer that Citigroup has submitted and are not binding on any other person or entity in this or any other proceeding by the Commission.

[2] While these transactions took the form of commodity trades, investments in partnerships, and sales of assets, in each transaction, Citigroup made its decision to participate largely on the basis of its analysis of credit risk.

[3] Fair value accounting (sometimes referred to as mark-to-market accounting) generally refers to the practice of recording certain types of assets and liabilities at their current fair value rather than their historical cost, such that any changes in the fair value of those assets and liabilities are reflected as gains or losses for the reporting period in which the changes occurred.

[4] Enron and Citigroup formed a joint venture that purchased the pulp and paper assets that were the subject of Project Bacchus. The terms of this joint venture reduced Citigroup's exposure to Enron by replacing a funded commitment with a mostly un-funded contingent commitment. Specifically, Citigroup's investment in the joint venture — consisting of a relatively small cash investment and a contingent equity commitment — would be at risk only if the relevant pulp and paper assets lost their entire value.

[5] This type of transaction is referred to as a "prepay" because as originally developed it involved an immediate payment of funds by one party in return for the future delivery of a commodity by the counter-party.

[6] The net effect of the prepay structured transactions executed during the second quarter of 2001 also carried over to the third quarter of 2001 when reported net cash flow used in operations was $753 million (a negative amount in the statement of cash flows).

[7] In September 2002, the Commission issued a settled cease-and-desist order against Dynegy, *In the Matter of Dynegy Inc.*, Securities Exchange Act of 1934, Rel. No. 34-46537, and filed a settled civil suit against the company in the Southern District of Texas, Houston Division, *SEC v. Dynegy Inc.*, Civil Action No. H-02-3623 (S.D. Tex. 2002); Lit. Rel. No. 17744 (Sep. 25, 2002). The Commission made findings in the cease-and-desist order (and alleged in the civil complaint) that Dynegy committed securities fraud, among other violations, in connection with its failure to disclose and to account properly for Project Alpha. In settlement of the Commission's enforcement action, Dynegy, without admitting or denying the Commission's findings, agreed to the issuance of the cease-and-desist order and paid a civil penalty in the related civil suit.

[8] The initial lender in the Project Nahanni transaction was CXC Incorporated, a AAA-rated asset securitization company administered by Citigroup but owned by independent third parties. CXC raises funds by selling short-term commercial paper to third parties. In Project Nahanni, Citigroup provided a liquidity funding commitment to CXC. The purpose of the funding commitment was for Citigroup to fund the transaction, thus avoiding premature unwinding, if CXC was unable to raise enough funds in the commercial paper market. An insurance company provided a AAA-rated surety bond to CXC in favor of Citigroup.

[9] Citigroup arranged for the third-party investors to make a three percent equity investment in Nahanni to avoid consolidation under the Generally Accepted Accounting Principles ("GAAP") guidance then in effect.

[10] The parties used T-bills with maturity of 120 days on the theory that they were non-cash "merchant investments." To include sales of these T-bills in its cash from operating activities, Enron broadened the description of its

"merchant investments" — set forth in the Consolidated Financial Statements accompanying Enron's 1999 Annual Report on Form 10-K — to include government securities with maturities of more than 90 days. The broadening of the description of "merchant investments" made it appear that Enron invested in T-bills in the normal course of its merchant investment business which was described as "provid[ing] capital primarily to energy and communications-related businesses seeking debt or equity financing."

[11] Enron disclosed certain aspects of the Project Nahanni transaction in the notes to its 1999 Consolidated Financial Statements. However, this disclosure, especially when combined with the broadened description of merchant investments, was incomplete and misleading. While Citigroup was not involved with drafting Enron's disclosure, complete and candid disclosure of the way the Project Nahanni transaction used T-bills to create cash flow from operating activities would have defeated the purpose of the structure.

[12] The redemption of Nahanni's interest was only partial because the third-party investors' $15 million equity contribution had to remain invested and at risk throughout the term of the transaction to keep the structure in place.

[13] Citigroup charged Enron a one-time fee of $5 million to structure Project Nahanni. In addition, Citigroup charged a program fee in connection with the loan to Nahanni and a return on the liquidity facility, which remained un-drawn during the transaction.

[14] To treat a transfer of assets as a sale under SFAS 125, the transferor must surrender control of those assets. The transferor is considered to have surrendered control, under SFAS 125, if the transferred assets have been isolated from the transferor; the transferee has the unconstrained right to pledge or exchange the transferred assets or the transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the unconstrained right to pledge or exchange those interests; the transferor does not maintain effective control over the transferred assets through an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity or an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable. SFAS 125 has been superseded by Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a Replacement of FASB Statement No. 125."

[15] Because Enron did not use a qualifying special purpose entity, it was required to apply other consolidation accounting rules to any entity to which the assets were transferred to determine whether that entity would have to be consolidated. *See* EITF Issue 96-20, "Impact of FASB Statement No. 125 on Consolidation of Special-Purpose Entities," and "A Guide to Implementation of Statement 125 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," Question 35.

The accounting literature that applies to consolidation of non-qualifying special purpose entities requires among other things, that the majority owner of the entity be an independent third party who has made a substantial capital investment in the SPE. *See* EITF Abstracts, Appendix D, Topic D-14, and EITF Issue Nos. 90-15 and 96-21. The minimum capital

investment generally considered necessary under the then existing literature was three percent of capitalization. *See* EITF Issue No. 90-15, the Response to Question 3. This minimum investment must remain at risk throughout the life of the SPE. *See* EITF Issue No. 90-15 and EITF Abstracts, Appendix D, Topic D-14.

[16] Enron and Citigroup formed this joint venture as part of a larger transaction, called Project Sundance ("Sundance"), that Enron designed to allow it to obtain off-balance sheet treatment for all of its pulp and paper assets. Citigroup's funding in the Sundance joint venture included a $28 million equity investment that could be lost only if the assets Enron contributed to the Sundance joint venture lost their entire value, and an additional $160 million contingent equity commitment that Citigroup would be required to fund only if, among other things, the assets Enron contributed to the Sundance joint venture lost their entire value. The net effect of Sundance was to replace Citigroup's $200 million exposure to Enron in Bacchus with a low-probability contingent-funding obligation. In addition, Enron used Sundance to record a $20 million profit.

[17] Enron classified the equity interest as a "merchant investment." As a result, the sale of the equity interest in these pulp and paper assets would generate cash flow from operating activities.

[18] Many significant aspects of Bacchus are not discussed in this Order because they are not relevant for purposes of this Order. This Order does not address whether those aspects of the transaction were appropriate.

[19] While certain structural details of the other Enron-Citigroup transactions varied, all had the following characteristics:

(1) The commodity price risk was transferred back to Enron;

(2) Enron received an upfront payment that it immediately classified as cash from operating activities;

(3) Citigroup received fixed installment payments over a specified period of time;

(4) The installment payments were structured so as to provide a pre-determined return that was independent of any fluctuations in prices for the referenced underlying commodity; and

(5) A third party was inserted in the structure in order for Enron to satisfy its auditors' criteria for treating prepay transactions as operating activities.

[20] As noted, in some of the transactions, other financial institutions participated as the necessary third party. The role of those institutions was no different than the role of Delta: they participated solely to achieve the accounting treatment Enron sought.

[21] In connection with these transactions, Enron's auditors requested that Enron obtain a letter signed by Delta containing certain representations

relating to Delta's status and operations. The letter, the form and content of which were negotiated and approved by Enron's auditors, and which Citigroup helped draft and get executed, made the requested representations as follows:

> There is no restriction in the corporate documentation of [Delta] limiting the number of entities with which [Delta] may conduct business. [Delta] has undertaken business with a number of entities.
>
> [Delta] has assets other than those acquired through transactions with Enron Corp. and its subsidiaries and affiliates (collectively "Enron").
>
> [Delta] has unencumbered assets, which are available for application towards obligations owed to its creditors.

These representations, while perhaps technically true, supported Enron's desired accounting treatment by ignoring the fact that Delta had little substance, concentrating instead on its form, *i.e.*, the appearance that it was an independent entity.

[22] The offering memoranda specifically advised that the structure employed "blind-pool trusts" whereby investors would not know the exact nature of the trust investments.

[23] Enron prepared its statements of cash flows using a method that reconciled net income to the amount of net cash generated by (or used in) operations that indicated whether, on a net basis, Enron's cash inflows and outflows from operations were positive or negative; *i.e.*, generating or using cash. Enron's prepay transactions had the effect of overstating this balance — either by causing net cash *generated* by operating activities (a positive cash flow) to be higher or by causing net cash *used* in operating activities (a negative cash flow) to be less than what otherwise would have been reported.

[24] By investing in the Alpha CLN, the financial institutions assumed Dynegy credit risk. To hedge that risk, Citigroup also entered into credit default swaps, whereby in the event of a Dynegy bankruptcy, Citigroup was required to compensate the institutions in an amount equivalent to the recovery of an unsecured creditor of Dynegy.

[25] The purchase price of the gas under the Gas Contract has a 86 percent variable component and 14 percent fixed component. Specifically, for the first nine months, the 86 percent variable component was at market price, minus a pre-determined discount (i.e., NYMEX settlement price less a Base Period Price Adjustment). For the remaining 51 months, the 86 percent variable component is to be at market price, plus a pre-determined premium (i.e., NYMEX settlement price plus a Term Period Price Adjustment). For all 60 months, the remaining 14 percent is at a fixed price.

[26] Where certain cash receipts and payments may have aspects of different types of cash flow, "the appropriate classification shall depend on the activity that is likely to be the predominant source of cash flow for the item."

[27] ABG Supply's equity investors also hedged all interest rate risk associated with Alpha, by entering into interest rate swaps and credit default swaps with Citigroup. The net effect of these swaps is that, in connection with Alpha, the only risk the ABG Supply equity investors face is the risk of Dynegy's default, in which event the equity owners' claims against Dynegy would be subordinate to claims of the CLN syndicate lenders.

[28] The cross-termination provisions evidence the fact that the swaps were not conducted in the ordinary course, but rather, to facilitate Alpha. Dynegy's accounting advisors specifically told Dynegy representatives that the cross-termination provisions would require recording the Alpha-based proceeds as cash flow from financing.

http://www.sec.gov/litigation/admin/34-48230.htm

EXHIBIT C

U.S. Department of Justice

Enron Task Force

Washington, D.C. 20530

September 17, 2003

Robert S. Morvillo, Esq.
Morvillo, Abramowitz, Grand, Iason & Silberberg
565 Fifth Avenue
New York, NY 10022

Charles Stillman, Esq.
Stillman & Friedman
425 Park Avenue
New York, NY 10022

Re: Merrill Lynch & Co., Inc.

Dear Messrs. Stillman and Morvillo:

This letter sets forth the agreement between the Department of Justice, by the Enron Task Force (the "Department") and Merrill Lynch & Co., Inc. ("Merrill Lynch").

Introduction

1. The Department is conducting a criminal investigation into matters relating to the collapse of the Enron Corp. ("Enron"). During the course of the investigation, the Department notified Merrill Lynch that, in the Department's view, Merrill Lynch personnel have violated federal criminal law. In particular, the Department notified Merrill Lynch that certain Merrill Lynch employees: a) violated federal criminal law in connection with certain transactions initiated at year-end 1999 (the "Year-End 1999 Transactions");[1] b) aided and abetted Enron's violation of federal criminal law in connection with the same transactions; and c) knowingly made, and caused others to make, false statements before various tribunals, including a federal grand jury, the United States Congress, the United States Securities and Exchange Commission ("SEC") and a court-appointed bankruptcy examiner.

[1] These transactions relate to: a) Merrill's temporary "purchase" from Enron of Nigerian power barges (Enron Nigeria Barge Ltd.) and subsequent sale of the barges; and b) offsetting energy trades involving back-to-back options (the Enron Power Marketing, Inc. energy transactions).

2. Merrill Lynch acknowledges that the Department has developed evidence during its investigation that one or more Merrill Lynch employees may have violated federal criminal law. Merrill Lynch accepts responsibility for the conduct of its employees giving rise to any violation in connection with the Year-End 1999 Transactions. Merrill Lynch does not endorse, ratify or condone criminal conduct and, as set forth below, has taken steps to prevent such conduct from occurring in the future.

Agreement

3. Based upon Merrill Lynch's acceptance of responsibility in the preceding paragraph, its adoption of the measures set forth herein, its commitment to implement and audit such measures and its willingness to continue to cooperate with the Department in its investigation of matters relating to Enron, the Department, on the understandings specified below, agrees that the Department will not prosecute Merrill Lynch for any crimes committed by its employees relating to the Year-End 1999 Transactions. Merrill Lynch understands and agrees that if it violates this Agreement, the Department can prosecute Merrill Lynch for any crimes committed by its employees relating to the Year-End 1999 Transactions. This Agreement does not provide any protection to any individual or any entity other than as set forth above.

The understandings on which this Agreement is premised are:

4. Merrill Lynch shall truthfully disclose all information with respect to the activities of Merrill Lynch, its officers and employees concerning all matters relating to the Year-End 1999 Transactions about which the Department shall inquire, and shall continue to fully cooperate with the Department. This obligation of truthful disclosure includes an obligation upon Merrill Lynch to provide to the Department, on request, any document, record or other tangible evidence relating to the Year-End 1999 Transactions about which the Department shall inquire of Merrill Lynch. This obligation of truthful disclosure includes an obligation to provide to the Department access to Merrill Lynch's facilities, documents and employees. This paragraph does not apply to any information provided to counsel after July 31, 2000 in connection with the provision of legal advice and the legal advice itself.

5. Upon request of the Department, with respect to any issue relevant to its investigation of Enron, Merrill Lynch shall designate knowledgeable employees, agents or attorneys to provide non-privileged information and/or materials on Merrill Lynch's behalf to the Department. It is further understood that Merrill Lynch must at all times give complete, truthful and accurate information.

6. With respect to any information, testimony, document, record or other tangible evidence relating to Enron provided to the Department or a grand jury, Merrill Lynch consents to any and all disclosures to Governmental entities of such materials as the Department, in

its sole discretion, deems appropriate. With respect to any such materials that constitute "matters occurring before the grand jury" within the meaning of Rule 6(e) of the Federal Rules of Criminal Procedure, Merrill Lynch further consents to a) any order sought by the Department permitting such disclosure and b) the Department's ex parte or in camera application for such orders. To the extent that the Department provides material pursuant to this paragraph to non-governmental parties, the Department will provide Merrill Lynch with 10 days advance notice, to the extent practicable, of what materials are to be provided and to whom.

7. Merrill Lynch further agrees that it will not, through its attorneys, board of directors, agents, officers or employees make any public statement, in litigation or otherwise, contradicting Merrill Lynch's acceptance of responsibility set forth above. Any such contradictory statement by Merrill Lynch, its attorneys, board of directors, agents, officers or employees shall constitute a breach of this Agreement, and Merrill Lynch thereafter would be subject to prosecution as set forth in paragraph 3 of this Agreement. Upon the Department's notifying Merrill Lynch of such a contradictory statement, Merrill Lynch may avoid a breach of this Agreement by publicly repudiating such statement within 48 hours after notification by the Department. This paragraph is not intended to apply to any statement made by any Merrill Lynch employee who has been charged with a crime.

8. Merrill Lynch agrees to adopt and implement by December 1, 2003, specific new policies and procedures relating to the integrity of client and counterparty financial statements and year-end transactions (the "Policies and Procedures"). The Policies and Procedures to which Merrill Lynch agrees are described in Exhibit A to this Agreement. Nothing in this Agreement precludes Merrill Lynch from amending or changing its Policies and Procedures in the future so long as said amendments or changes do not diminish the policies and procedures as set forth in Exhibit A. During the 18 month period set forth in paragraph 9 below, no amendments or changes will be made to the Policies and Procedures without the approval of the auditing firm and the individual attorney referred to in paragraph 9 below.

9. Merrill Lynch also agrees that for a period of 18 months, it will retain an independent auditing firm to undertake a special review of the Policies and Procedures set forth in Exhibit A. Merrill Lynch also will retain an individual attorney selected by the Department, who shall be acceptable to Merrill Lynch, to review the work of the auditing firm. The auditing firm and the attorney shall:

    a) ensure that the Policies and Procedures are appropriately designed to accomplish their goals;
    b) monitor Merrill Lynch's implementation of and compliance with the Policies and Procedures; and
    c) report on at least a semi-annual basis to the General Counsel of Merrill Lynch and the Head of Corporate Audit as to the effectiveness of the

Policies and Procedures. The General Counsel shall then present a summary of this report to the Audit Committee of the Board of Directors for its review. Copies of these reports shall be submitted to the Department during this 18 month period.

10. It is further understood that should the Department, in its sole discretion, determine that Merrill Lynch has given deliberately false, incomplete, or misleading information under this Agreement, or has committed any crimes, or that Merrill Lynch otherwise violated any provision of this Agreement, Merrill Lynch shall, in the Department's sole discretion, thereafter be subject to prosecution for any federal criminal violation of which the Department has knowledge. Any such prosecutions may be premised on information provided by Merrill Lynch. Moreover, Merrill Lynch agrees that any prosecutions relating to Enron that are not time-barred by the applicable statue of limitations on the date of this Agreement may be commenced against Merrill Lynch in accordance with this Agreement, notwithstanding the expiration of the statute of limitations between the signing of this Agreement and June 30, 2005. By this Agreement Merrill Lynch expressly intends to and does waive any rights in this respect.

11. It is further agreed that in the event that the Department, in its sole discretion, determines that Merrill Lynch has violated any provision of this Agreement; a) all statements made by or on behalf of Merrill Lynch to the Department, or any testimony given by Merrill Lynch before a grand jury, the United States Congress, the SEC, or elsewhere, whether prior or subsequent to this Agreement, or any leads derived from such statements or testimony, shall be admissible in evidence in any and all criminal proceedings brought by the Department against Merrill Lynch and b) Merrill Lynch shall not assert any claim under the United States Constitution, Rule 11(e)(6) of the Federal Rules of Criminal Procedure, Rule 410 of the Federal Rules of Evidence, or any other federal rule, that statements made by or on behalf of Merrill Lynch prior to or subsequent to this Agreement, or any leads therefrom, should be suppressed.

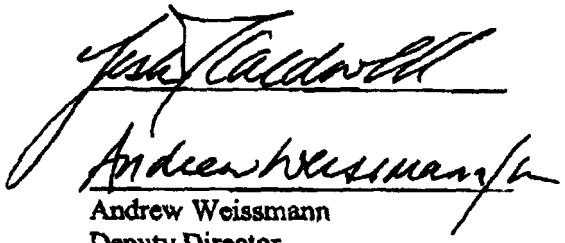
12. The decision whether conduct and/or statements of any individual will be imputed to Merrill Lynch for the purpose of determining whether Merrill Lynch has violated any provision of this Agreement shall be in the sole discretion of the Department.

13. This Agreement expires on June 30, 2005. It is further understood that this Agreement is binding only on the Department and Merrill Lynch.

14. This Agreement may not be modified except in writing signed by all the parties.

Very truly yours,

LESLIE R. CALDWELL
Director, Enron Task Force



Andrew Weissmann
Deputy Director

MERRILL, LYNCH & CO., INC.

_____

_____
Robert Morvillo, Esq.
Counsel to Merrill, Lynch & Co.

_____
Charles Stillman, Esq.
Counsel to Merrill, Lynch & Co.

14. This Agreement may not be modified except in writing signed by all the parties.

Very truly yours,

LESLIE R. CALDWELL
Director, Enron Task Force

_____

_____
Andrew Weissmann
Deputy Director

MERRILL LYNCH & CO., INC.

by Barry J. Mandel
Barry J. Mandel
SVP and General Counsel, Global Litigation and Employment

_____
Robert Morvillo, Esq.
Counsel to Merrill, Lynch & Co.

_____
Charles Stillman, Esq.
Counsel to Merrill, Lynch & Co.

EXHIBIT A

MERRILL LYNCH POLICIES AND PROCEDURES ON THE INTEGRITY OF CLIENT AND COUNTER-PARTY FINANCIAL STATEMENTS AND YEAR-END TRANSACTIONS

The following sets forth Merrill Lynch & Co. Inc.'s plan for addressing the integrity of client and counterparty ("Third Party") transactions and year-end transactions. All employees must comply with the policies and procedures and violation of these policies and procedures may lead to disciplinary action, including termination.

General Prohibitions and Rules

Misleading Third Party Activities. Merrill Lynch may not engage in any transaction where Merrill Lynch knows or believes that an objective of the Third Party is to achieve a misleading earnings, revenue or balance sheet effect.

- Undocumented Agreements. Merrill Lynch will not engage in any transaction in which any term of the transaction related to risk transfer (whether or not legally enforceable) is not reflected in the written contractual documentation for the transaction.

- Transactions With Agreed-Upon Early Terminations. Merrill Lynch will not engage in any transaction in which there is an agreement between the parties (whether or not legally enforceable) to unwind such transaction prior to its stated maturity at an agreed-upon price unless Merrill Lynch accurately reflects the agreed-upon unwind on its books and records and provides a written summary of such transaction and unwind to the independent auditor of the Third Party.

- Offsetting Transactions. Merrill Lynch will not engage in any transaction having a substantially contemporaneous off-setting "leg" which offsets, in whole or substantially all of, the economics of the other leg of the transaction and is transacted with the same Third Party (or affiliate, related party or special purpose entity of the Third Party), unless such transaction is specifically approved by the Special Structured Products Committee ("SSPC").

Individual Accountability. Each employee responsible for proposing that Merrill Lynch enter into any transaction covered by these policies shall satisfy himself/herself that he/she is fully knowledgeable about all terms and agreements related to such transactions and that all applicable provisions of these policies and procedures and other Merrill Lynch policies and procedures have been fulfilled prior to execution.

Special Restrictions Applicable to Year-End Transactions

In light of the heightened danger of abuse in connection with "Year-End Transactions," the following policies and procedures apply specifically to such transactions:

- Transactions Motivated by Accounting and Balance Sheet Considerations. Merrill Lynch will not engage in any Year-End Transaction where Merrill Lynch knows or believes that the Third Party's primary motivation is to achieve accounting (including off-balance sheet treatment) objectives, unless such transaction is specifically approved by the SSPC.

New Committee and New Committee Approval Process

- Merrill Lynch will create a new committee and new approval process by creating the SSPC.

- The SSPC will review the Year-End Transactions and Offsetting Transactions referred to above.

- The SSPC also will review all complex structured finance transactions effected by a Third Party with Merrill Lynch. A "Complex Structured Finance Transaction" means any structured transaction where:

  (i) a known or believed material objective of such transaction is to achieve a particular accounting or tax treatment, including the objective of transferring assets off-balance sheet;

  (ii) there is material uncertainty with regard to the legal or regulatory treatment of such transaction; or

  (iii) the transaction provides the Third Party with the economic equivalent of a financing which, if characterized as a financing, would require relevant commitment committee approval.

- The SSPC will also review all early unwinds of any Complex Structured Finance Transaction and any Year End Transaction and any termination of such transaction prior to its originally contemplated maturity.

- The SSPC also will review any transaction, which any member of the SSPC determines is appropriate for SSPC review.

- Merrill Lynch will not engage in any transaction within the purview of the SSPC without the transaction receiving the approval of the SSPC.

- The SSPC will be composed of senior representatives (Head of group or experienced designee) of the various disciplines of the firm including Market Risk, Law and Compliance, Accounting, Finance, Tax and Credit. No transaction will be

deemed approved by the SSPC without the approval of all of the Heads of group (or experienced designee). The Committee will record each decision made in connection with any transaction and keep a record of the participants in any such meetings.

- The SSPC will be responsible for the effective management of all risks associated with transactions within its purview. As a result, the committee will ensure that an assessment of legal and reputational risk is undertaken with respect to each transaction. In this regard, the committee will review a variety of factors, including, without limitation, an assessment of whether financial, accounting, rating agency disclosure or other issues associated with a transaction are likely to create legal or reputational risks.

- To the extent the SSPC determines that any legal or reputational concern is present, it will review the overall customer relationship with the Third Party and shall obtain as a condition precedent to further review and approval, complete and accurate information about the Third Party's proposed accounting treatment of the contemplated transaction and the effect of the transaction on the Third Party's financial disclosure. To the extent the information provided is insufficient or unsatisfactory, the transaction will not be approved by the SSPC or executed by Merrill Lynch. If the SSPC determines that the proposed transaction is suspicious, it will refer the matter to Merrill Lynch's Global Money Laundering Reporting Officer.

- For each transaction considered, the SSPC will require the transaction sponsor to represent that such person is providing complete and accurate information regarding the transaction and the Third Party's purpose(s) for such transaction.

- In addition, a full description of each transaction approved by the SSPC will be communicated in writing to the independent auditor of the applicable Third Party.

Referrals to the SSPC

Merrill Lynch shall communicate to its GMI employees the substance of the following:

To ensure that all transactions that require approval of the SSPC are referred to that committee, these policies and procedures call for a broad category of transactions to be referred to the SSPC so that the SSPC can make the determination whether the transactions need the committee's approval. Accordingly, Merrill Lynch employees shall refer to the SSPC all transactions that

- An employee knows or believes may be motivated in whole or in part by the Third Party's desire to achieve a misleading earnings, revenue or balance sheet effect. Such referrals may be made anonymously, using the Merrill Lynch hotline (discussed below), or by other means.

- An employee knows or believes involve a contemplated agreement or understanding between the parties (whether or not legally enforceable) to unwind such transactions prior to its stated maturity at an agreed-upon price.

- Are Year-End Transactions as to which an employee knows or believes that the Third Party's primary motivation is to achieve accounting (including off-balance sheet treatment) objectives.

- Are transactions having a substantially contemporaneous off-setting "leg" which offsets, in whole or substantial aspects of, the economics of the other leg of the transaction and is transacted with the same Third Party (or affiliate, related party or special purpose entity of the Third Party).

Employees shall err on the side of referral to the SSPC if they have any question as to whether a transaction falls within the SSPC purview. Failure to refer transactions to the SSPC will be grounds for discipline, including dismissal.

- The formation and mandate of the SSPC, as well as the policies and procedures set forth herein, shall be communicated to all GMI employees and the various Product and Regional Chief Operating Officers shall be responsible for ensuring all applicable transactions are referred to the Committee for review. In this connection, Corporate Audit shall periodically monitor the referral process to ensure that it meets the objectives of the SSPC.

New Training Program

- Merrill Lynch will develop a comprehensive training program (to include computer training and formal training sessions) for all GMI personnel and all personnel supporting GMI (including all applicable Finance, Credit, Market Risk, Tax, Law and Compliance and Operations personnel) that will highlight issues/factors which, if present in a transaction, would warrant additional scrutiny. Among the specific issues to be addressed in the training are the new policies set forth above. Other issues/factors which may warrant additional scrutiny of the transaction and which will be included in the training program include but are not limited to the following;

    - Transactions where there is significant uncertainty with regard to the legal or regulatory treatment of the proposed transaction
    - Transactions with pre-agreed profit/loss sharing or return on equity/return on investment arrangements with the counter-party
    - Transactions known to be effected as a result of or in connection with changes to accounting principles or standards
    - Transactions with back-to-back (circular) cash flows between ML and the Third Party or its special purpose entity

Development of a Website

- Merrill Lynch will develop a GMI Policy and Approval Process Website that will articulate Merrill Lynch's applicable policies and the required approval process for the types of transactions described herein. This website will be available to all employees.

Employee Concerns, Ethics Hotline, Confidential Reporting

- The interactive website referenced above will provide opportunities for employees to communicate with the members of the SSPC concerning any reservations any such employee may have with any GMI transaction or the approval process related thereto.

- Additionally, employees will be encouraged to utilize the firm's Ethics Hotline as a mechanism to report inappropriate behavior and/or any failure to properly abide by these policies. Such reports may be made on a confidential and anonymous basis, and Merrill Lynch will not tolerate retaliation against those reporting any suspected violation in good faith. Those found to have retaliated will be subject to immediate dismissal.

Definitions

- "Year-End Transaction" shall mean any transaction effected within twenty-one (21) days of a Third Party's fiscal year-end period where there are continuing obligations between the parties subsequent to the year end period.

- "Third Party", "client" or "counterparty" shall mean any U.S. corporation that is registered under the Securities Exchange Act of 1934, any domestic or foreign affiliate of such corporation, any entity directly or indirectly controlled by such corporation, and any special purpose entity set up by such corporation.

EXHIBIT D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES OF AMERICA,	§	
	§	
v.	§	Cr. No. H-03-
	§	
DANIEL BAYLY,	§	Violations: 18 U.S.C. §§ 371 (Conspiracy);
JAMES A. BROWN, and	§	1503 (Obstruction of Justice);
ROBERT S. FURST,	§	1623 (Perjury)
	§	
Defendants.	§	

INDICTMENT

The Grand Jury charges:

I. Introduction

A. Enron

1. At all times relevant to this Indictment, Enron Corp. ("Enron") was an Oregon corporation with its headquarters in Houston, Texas. Among other businesses, Enron was engaged in the purchase and sale of natural gas, construction and ownership of pipelines and power facilities, provision of telecommunication services, and trading in contracts to buy and sell various commodities. Before it filed for bankruptcy on December 2, 2001, Enron was the seventh largest corporation in the United States.

2. Enron was a publicly traded company whose shares were listed on the New York Stock Exchange. As a public company, Enron was required to comply with regulations of the United States Securities and Exchange Commission ("SEC"). Those regulations protect

members of the investing public by, among other things, ensuring that a company's financial information is accurately recorded and disclosed to the public.

3. Under SEC regulations, Enron and its officers had a duty to make and keep books, records and accounts that fairly and accurately reflected Enron's business transactions, and file with the SEC reliable quarterly and annual reports.

4. Co-conspirator Andrew S. Fastow was Enron's Chief Financial Officer ("CFO") from March 1998 to October 24, 2001. As CFO, Fastow had oversight over many of Enron's financial activities. During the time that he served as Enron's CFO, Fastow also served as the general partner and otherwise was in control of certain special purpose entities with which Enron did business, including LJM 2 Co-Investment, L.P. and its affiliates ("LJM2").

5. Co-conspirator Daniel O. Boyle joined Enron in 1998 and held a variety of positions, including Vice President in Global Finance. Boyle was a lead employee assigned to effectuate the Nigerian barge transaction discussed below.

6. As Enron employees, Fastow and Boyle each owed a duty to Enron and its shareholders to provide the company with their honest services.

B. Merrill Lynch & Co., Inc.

7. Merrill Lynch & Co., Inc. ("Merrill Lynch") was a Delaware corporation with its headquarters in New York, New York. Merrill Lynch was a major financial institution, with offices in Houston and Dallas, Texas, among other places. Merrill Lynch engaged in business with various leading corporations, including Enron.

8. At all times relevant to Count One of this Indictment, defendant DANIEL BAYLY was the head of the Global Investment Banking division at Merrill Lynch; defendant JAMES A.

BROWN was the head of Merrill Lynch's Strategic Asset Lease and Finance group; and defendant ROBERT S. FURST was the Enron relationship manager for Merrill Lynch in the investment banking division and as such was responsible for generating business for Merrill Lynch from Enron. Defendants BAYLY, BROWN, and FURST were all Managing Directors of Merrill Lynch.

II. The Nigerian Barge Transactions

9. Enron and Merrill Lynch engaged in a year-end 1999 deal that involved the "parking" of Enron assets with Merrill Lynch. The parking of the assets with Merrill Lynch enabled Enron to enhance fraudulently its year-end 1999 financial position that it presented to the public and pay to Enron executives unwarranted bonuses. By facilitating Enron's deception, Merrill Lynch solidified its status as a "friend of Enron" and thereby positioned itself to receive an increased slice of the lucrative deals that Enron dispensed to financial institutions. Defendants DANIEL BAYLY, JAMES A. BROWN, and ROBERT S. FURST, along with coconspirators Andrew S. Fastow and Daniel O. Boyle, and others, all knowingly participated in this illegal scheme.

10. In 1999, Enron unsuccessfully sought to sell an interest in electricity-generating power barges moored off the coast of Nigeria. When Enron failed to sell the project by December 1999, Enron through Fastow, Boyle, and others arranged for Merrill Lynch to serve as a temporary buyer so that Enron could record earnings and cash flow in 1999 and thus appear more profitable to the public than it in fact was. Merrill Lynch agreed to pay $28 million for the barges, with 75% of that amount fronted by Enron itself. Merrill Lynch's purchase of the Nigerian barges allowed Enron to record improperly $12 million in earnings and $28 million in funds flow in the fourth quarter of 1999. Those inflated numbers in turn enabled the business

unit from which the barge deal emanated to meet its targeted financial goals for the year, which in turn led to increased unwarranted bonuses to executives in that business unit.

11. Merrill Lynch, through defendants DANIEL BAYLY, JAMES A. BROWN, and ROBERT S. FURST, and others, agreed to purchase the Nigerian barges only because Merrill Lynch knew that the "purchase" was not real. Enron promised Merrill Lynch that it would receive a return of its investment plus an agreed-upon profit within six months. Specifically, Enron promised in an oral "handshake" side-deal that Merrill Lynch would receive a rate of return of approximately 22% and that Enron would sell the barges to a third party or repurchase the barges within six months. Because of these promises from Enron, Merrill Lynch's supposed equity investment was not truly "at risk" and Enron should not have treated the transaction as a sale from which earnings and cash flow could be recorded in 1999.

12. In order to mask the full agreement from regulators and auditors, Enron and Merrill Lynch entered into written agreements on December 29, 1999, that gave the outward appearance that Merrill Lynch was truly buying the Nigerian barges and accepting all the risks and rewards of an equity investment. Hidden from outside parties were the oral components of the agreement between the parties, which guaranteed Merrill Lynch a rate of return and set a deadline by which Merrill Lynch would no longer hold the barges for Enron.

13. On June 29, 2000, with no true third-party purchaser having been found to buy Merrill Lynch's interest as the six-month deadline loomed, Enron arranged for LJM2, which was operated and controlled by Fastow, to purchase Merrill Lynch's interest. Without any negotiation between Merrill Lynch and LJM2 as to the purchase price, Enron caused LJM2 to pay $7,525,000 to Merrill Lynch, which represented a $525,000 premium over Merrill Lynch's

original investment to account for the agreed-upon approximate 22% rate of return promised by Enron. Enron also agreed to pay LJM2 a substantial but undisclosed fee for entering into the deal with Merrill Lynch. Enron subsequently arranged for a third party to purchase LJM2's interest in the barges, again at a profit to LJM2.

III. The Defendants' Obstruction of The Investigations Into The Nigerian Barge Transactions

14. The Nigerian barge transactions have been the subject of investigation by various entities. To hide their criminal conduct, the defendants DANIEL BAYLY, JAMES A. BROWN, and ROBERT S. FURST, and others, obstructed each of those investigations.

A. The Enron Grand Jury Investigation

15. In March 2002, a special Grand Jury empaneled in the Southern District of Texas (the "Enron Grand Jury") commenced a criminal investigation of all matters relating to Enron's collapse involving potential violations of the federal criminal laws, including an examination of financial institutions' employees who may have conspired with and aided and abetted Enron's employees in criminal offenses. Among other matters, the Enron Grand Jury has examined the Nigerian barge transactions to determine whether Enron and Merrill Lynch entered into an oral side agreement in December 1999. As part of that investigation, the Enron Grand Jury has heard from dozens of witnesses and reviewed voluminous records from Enron, Merrill Lynch, and LJM2, among others.

16. As part of its investigation concerning the Nigerian barge transactions, on September 25, 2002, the Enron Grand Jury called as a witness defendant JAMES A. BROWN to testify. While under oath, defendant BROWN testified falsely as to a material matter by stating, among other things, that he did not know of any oral promise between Enron and Merrill Lynch relating

to the barge transaction.

B. The SEC Investigation

17. The SEC has conducted a civil investigation into the Nigerian barge transactions as part of its larger investigation into the collapse of Enron. It too sought to determine whether there was an oral side agreement between Enron and Merrill Lynch. As part of its investigation it interviewed and deposed numerous witnesses and reviewed voluminous documents concerning the barge transactions.

18. On July 10, 2002, the SEC called defendant DANIEL BAYLY as a witness to testify under oath in a deposition concerning the barge transactions. Defendant BAYLY testified falsely as to a material matter by stating, among other things, that he did not know of any oral guarantee between Enron and Merrill Lynch relating to the barge transaction.

19. On November 20, 2002, the SEC called defendant JAMES A. BROWN as a witness to testify under oath in a deposition concerning the barge transactions. Defendant BROWN again testified falsely as to a material matter by stating, among other things, that he did not know of any oral agreement between Enron and Merrill Lynch relating to the barge transaction.

C. The Congressional Investigation

20. In the summer of 2002, the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate ("the Congressional Committee") conducted an investigation and hearing concerning, among other things, the Nigerian barge transactions. As part of that investigation, which was conducted pursuant to the authority of the Congressional Committee consistent with applicable rules of that body, the staff of the Congressional Committee interviewed and deposed witnesses and reviewed hundreds of

documents concerning the transactions.

21. On July 17, 2002, the staff of the Congressional Committee interviewed defendant ROBERT S. FURST concerning the barge transactions. Defendant FURST made false statements as to a material matter by stating, among other things, that he did not know of any oral promise or guarantee between Enron and Merrill Lynch relating to the barge transaction.

22. The staff of the Congressional Committee also sought to interview defendant JAMES A. BROWN concerning the Nigerian barge transactions. Defendant BROWN authorized the submission of information concerning the barge transaction to the Congressional Committee staff. On July 28, 2002, defendant BROWN caused his agents to make false statements as to a material matter by causing them to state, among other things, that BROWN did not know of any oral promise or guarantee between Enron and Merrill Lynch relating to the barge transaction.

23. On July 30, 2002, the staff of the Congressional Committee deposed defendant DANIEL BAYLY under oath concerning the barge transaction. Defendant BAYLY testified falsely as to a material matter by testifying, among other things, that he did not know of any oral commitment or guarantee between Enron and Merrill Lynch relating to the barge transaction.

D. The Bankruptcy Examiner Investigation

24. On or about May 24, 2002, the United States Bankruptcy Court for the Southern District of New York approved the appointment by the United States Trustee of a Bankruptcy Examiner ("the Bankruptcy Examiner") to inquire into a broad array of Enron transactions. As part of the Bankruptcy Examiner's inquiry, it interviewed and deposed witnesses and reviewed voluminous documents concerning the Nigerian barge transactions.

25. On April 28, 2003, the Bankruptcy Examiner called defendant JAMES A. BROWN

as a witness to testify under oath in a deposition concerning the barge transactions. Defendant BROWN testified falsely to the Bankruptcy Examiner as to a material matter by stating, among other things, that he did not know of any oral promise or commitment between Enron and Merrill Lynch relating to the barge transaction.

26. Defendant BROWN also testified falsely in his testimony to the Bankruptcy Examiner concerning an E-mail that he sent to colleagues at Merrill Lynch dated March 2, 2001 ("the BROWN E-mail") concerning his suggestion that Merrill Lynch enter into an oral side-agreement in a deal with a company unrelated to Enron (the "Company"). The BROWN E-mail stated in relevant part:

> I'm not convinced yet that we can't obligate [the Company] more than Frank indicated, but I've been on the road the last 3 days and haven't been able to determine that. If its [sic] as grim as it sounds, I would support an unsecured deal provided we had total verbal surrances [sic] from [the Company] ceo or Cfo, and schulte was strongly vouching for it. We had a similar precedent with Enron last year, and we had Fastow get on the phone with [defendant Daniel] Bayly and lawyers and promise to pay us back no matter what. Deal was approved and all went well.

When questioned by the Bankruptcy Examiner about the BROWN E-mail, BROWN testified falsely that it did not accurately reflect the agreement between Enron and Merrill Lynch and that in the BROWN E-mail BROWN deliberately told his colleagues at Merrill Lynch something that was not true.

COUNT ONE
(Conspiracy to Commit Wire Fraud and Falsify Books and Records)

27. The allegations of paragraphs 1 through 26 are realleged as if fully set forth here.

28. In or about and between December 1999 and January 2001, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendants

DANIEL BAYLY, JAMES A. BROWN, and ROBERT S. FURST, along with co-conspirators Andrew S. Fastow and Daniel O. Boyle, and others conspired to: (a) knowingly and intentionally devise a scheme and artifice to defraud Enron and its shareholders, including to deprive them of the intangible right of honest services of its employees, and to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, and for the purpose of executing such scheme and artifice to transmit and cause to be transmitted by means of wire communication in interstate and foreign commerce writings, signs, signals, pictures and sounds, all in violation of Title 18, United States Code, Section 1343; and (b) knowingly and willfully falsify books, records and accounts of Enron in violation of Title 15, United States Code, Sections 78m(b) (2) (A) & (B), 78m(b) (5) and 78ff and Title 17, Code of Federal Regulations, Section 240.13b2-1.

OVERT ACTS

29. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendants DANIEL BAYLY, JAMES A. BROWN, and ROBERT S. FURST and their co-conspirators did commit and cause to be committed the following overt acts, among others:

a. In late December 1999, FURST caused a document that summarized the proposed Nigerian barge transaction between Enron and Merrill Lynch to be circulated within Merrill Lynch, including in Merrill Lynch's Houston, Texas office; the document stated that defendant BAYLY "will have a conference call with senior management of Enron confirming this commitment to guaranty the ML [Merrill Lynch] takeout within six months" and noted that the proposed return on the transaction would be "$250,000 plus 15% per annum or a flat 22.5%

return per annum."

b. In late December 1999, FURST spoke to BROWN concerning the terms of the proposed Nigerian barge transaction between Enron and Merrill Lynch.

c. On or about December 22, 1999, FURST, BROWN and others at Merrill Lynch attended a meeting to discuss the proposed Nigerian barge transaction.

d. On or about December 22, 1999, Merrill Lynch executives spoke with BAYLY concerning the proposed Nigerian barge transaction.

e. On or about December 23, 1999, BAYLY spoke on a conference call to Fastow in Houston, Texas, and Fastow promised BAYLY that Enron would take Merrill Lynch out of the deal within six months.

f. On or about December 29, 1999, in Houston, Texas and elsewhere, Enron and Merrill Lynch finalized their written agreement concerning the Nigerian barge transaction, which did not set forth the oral agreements reached between the parties.

g. On or about June 14, 2000, when Enron had not yet found a third party to buy the barges from Merrill Lynch, FURST, BROWN and others caused a letter to Enron to be drafted demanding payment by Enron of the agreed-upon return on its investment in the barges by June 30, 2000.

h. On or about June 14, 2000, in Houston, Texas, Fastow and others arranged for LJM2 to buy Merrill Lynch's investment in the barges, fulfilling the promise by Enron to Merrill Lynch that it would be bought out within six months at a rate of return of approximately 22%.

(Title 18, United States Code, Sections 371 and 3551 et seq.)

COUNT TWO
(BROWN: Perjury Before The Enron Grand Jury)

30. The allegations in paragraphs 1 through 26 are realleged as if fully set forth here.

31. On or about September 25, 2002, in the Southern District of Texas, defendant JAMES A. BROWN, while under oath and testifying in a proceeding before a Grand Jury of the United States, knowingly did make a false material declaration as set forth below.

32. At the time and place stated above, the Enron Grand Jury was conducting an investigation into potential federal criminal offenses relating to the Nigerian barge transactions. It was material to this investigation that the Enron Grand Jury determine all the terms of the agreements, whether written or oral, between Enron, Merrill Lynch, and LJM2.

33. At the time and place stated above, defendant BROWN, appearing as a witness and testifying under oath at a proceeding before the Enron Grand Jury, knowingly made the following declarations in response to questions with respect to matters material to the Grand Jury's investigation (the portions that have been underlined are false):

Q: Do you have any understanding of why Enron would believe it was obligated to Merrill to get them out of the deal on or before June 30th?

A. It's inconsistent with my understanding of what the transaction was.

(Tr. at 80, lines 6-11.)

Q: ...Again, do you have any information as to a promise to Merrill that it would be taken out by sale to another investor by June 2000?

A: In - - no, I don't - - the short answer is no, I'm not aware of the promise. I'm aware of a discussion between Merrill Lynch and Enron on or around the time of the transaction, and

I did not think it was a promise though.

Q: So you don't have any understanding as to why there would be a reference [in the Merrill Lynch document] to a promise that Merrill would be taken out by a sale to another investor by June of 2000?

A: No.

(Tr. at 88, lines 13-23.)

(Title 18, United States Code, Sections 1623 and 3551 et seq.)

COUNT THREE
(BROWN: Obstruction of the Enron Grand Jury Investigation)

34. The allegations of paragraphs 1 through 26, 32, and 33 are realleged as if fully set forth here.

35. On or about September 25, 2002, in the Southern District of Texas, defendant JAMES A. BROWN did corruptly endeavor to influence, obstruct, and impede the due administration of justice in that BROWN did knowingly and willfully make false and misleading declarations before the Grand Jury with intent to obstruct and impede the Enron Grand Jury investigation.

36. At the time and place stated above, BROWN corruptly endeavored to influence, obstruct, and impede the due administration of justice by giving false and misleading testimony

including, but not limited to, the declarations which are underscored in Count Two.

(Title 18, United States Code, Sections 1503 and 3551 et seq.)

Dated: Houston, Texas
September 16, 2003

A TRUE BILL

_____
FOREPERSON

Joshua R. Hochberg
Acting United States Attorney

LESLIE R. CALDWELL
Director, ENRON TASK FORCE

By: _____
ANDREW WEISSMANN
Deputy Director, ENRON TASK FORCE